JIM LEHRER: Our business correspondent Paul Solman of WGBH-Boston went south to begin our coverage of the growing mutual fund scandals.

PAUL SOLMAN: Oxford, home to the University of Mississippi, is named after its English forebear; its colors Yale blue and Harvard crimson; its buildings Greek revival. And then there's the football. This is the battleground, after all, of the running rebels whose retro -- some would say retrograde -- traditions combine nostalgia, cordiality, sports, and music in distinctly Southern ways.

PAUL SOLMAN: Parochial? Perhaps. But reveling before a game at Ole Miss is actually a national pastime. "Sports Illustrated" recently rated tailgating at the grove one of America's premier college events. Number three: Of all the 100 things you have to do in America before you graduate is the grove at Ole Miss.

MERCER BULLARD: Not just for a college student. This is a cultural Mecca in America.

PAUL SOLMAN: Law Professor Mercer Bullard came to Ole Miss from the SEC -- not the Southeast Conference, however, but the Securities and Exchange Commission, where as a regulator in charge of mutual funds, he got wind of a practice more audacious than Ole Miss tailgating: Illegal trading in mutual funds, which has turned into the latest scandal on Wall Street. In the past 20 years or so, some 90-plus million Americans have become shareholders in mutual funds because they're easy to invest in, provide diversification, and they've grown into a $7 trillion industry. Some of those shareholders were at the grove. Where's your money invested?

MERCER BULLARD: In mutual funds.

MAN 1: Mutual fund, yeah. I have a 401(k) as well as a separate mutual fund.

PAUL SOLMAN: Do you worry about the mutual fund taking advantage of you by increasing its own fees at your expense?

MAN 2: I'm not worried about that.

PAUL SOLMAN: Never?

MAN 3: Worry about the market.

PAUL SOLMAN: But you don't worry about the fund?
MAN 2: I've never... I've never thought of it that they would take advantage of you. Now you're giving me one more thing to worry about.

PAUL SOLMAN: What's hit the headlines lately is that a few mutual funds had been helping inside investors, and themselves, make money at the expense of their own smaller shareholders. The widening scandal has led to criminal charges, civil suits, and a number of axed executives. In New York, one hedge fund manager has pleaded guilty... and another has paid $40 million in fines. Executives at two mutual funds have been criminally charged. And New York state attorney general Eliot Spitzer has implicated at least three other mutual fund firms, and is planning criminal charges against Richard Strong, founder of Strong Capital Management, for illegally trading for his own account. Yesterday, Mr. Strong, a mutual fund industry pioneer, resigned as chairman of his fund's board of directors.

Finally, Massachusetts regulators have subpoenaed employees of some of the largest mutual fund firms in the country. Last week, along with the SEC, they sued Putnam Investments for civil securities fraud. Two former Putnam managers were also charged with illegally trading for their own accounts. Today, Putnam's president and CEO was forced out. And also today, Massachusetts announced that civil charges were imminent against former Prudential employees, and possibly Prudential Securities itself. While Ole Miss fans continued to fortify themselves for the annual homecoming game, Professor Bullard took us inside the law school's moot courtroom to explain the charges to a jury of his peers.

MERCER BULLARD: Ladies and gentlemen of the jury, could I have your attention for a moment?

PAUL SOLMAN: In a setting reminiscent of the courtroom dramas of Ole Miss alum John Grisham, Bullard had assembled a jury of business and law professors before which to make the case for the prosecution.

MERCER BULLARD: The first count is a count of stale pricing, and I'm going to use a little time to explain how stale pricing works.

PAUL SOLMAN: In fact, it was easier to understand stale pricing when Bullard explained it one-on-one with props.

MERCER BULLARD: I'm going to be the Earth over here, you are going to be the Sun. So pick up that lamp and turn it on, and shine it right over here on Hong Kong.

PAUL SOLMAN: Take Canary Capital and a mutual fund run by the Bank of America, which invested in global stock markets, including Hong Kong's.

MERCER BULLARD: All right, Paul. This is Hong Kong, where the securities of our hypothetical Hong Kong fund are actually being traded. And of course Hong Kong is
going to close around 4:00 Hong Kong time, which is 4 a.m. our time and as you can see, it's still dark over here in New York.

PAUL SOLMAN: Meanwhile, as the world turns, the U.S. Stock Market opens, and let's say it goes up. That almost surely drives up the value of stocks in Hong Kong the next day, but the Bank of America didn't update the price of its global fund...

MERCER BULLARD: Which is still based on what happened at the close of the day in Hong Kong.

PAUL SOLMAN: ...back 14 hours earlier.

MERCER BULLARD: Fourteen hours earlier.

PAUL SOLMAN: So in other words, if I'm buying the fund today, I'm buying it at yesterday's price.

MERCER BULLARD: That's exactly right. And not only are you buying at yesterday's price, you're buying it because you know the next day when the fund incorporates that new information, you're going to be able to sell out at a higher price.

PAUL SOLMAN: The key maneuver was that big insider investors like Canary were allowed to buy shares in the fund after U.S. trading, but before the international fund price was updated. They were able to trade on stale prices. And, get this, they were allegedly helped by the mutual fund manager.

MERCER BULLARD: So, we had a fund manager who not only had stale prices, we had a fund manager who was inviting in these investors to take advantage of the stale prices. We had a fund manager who was not only inviting them in, but giving them the money with which they could invest in the fund and cheat the fund manager's own shareholders by loaning them about $300 million at fairly high rates. This is how these fund managers made money on this practice.

PAUL SOLMAN: The fund manager then collected interest on the loan as a management fee. In return, the insiders got the loans, a computer terminal to trade directly with the fund, even an updated list of companies in the fund to take better advantage of the stale prices, at the expense of the fund's other shareholders.

MERCER BULLARD: When someone buys a share of the mutual fund, they're not buying it from the fund manager. They're buying it from you, the jury, the investors of America who are essentially selling those shares at a discount to the person who exploits that stale price.

PAUL SOLMAN: At his tent, Ole Miss alum Jeff Buckner, a financial planner for small investors, told us what he thinks of the mutual fund industry in general.
JEFF BUCKNER: It's not structured in a way that is aimed at doing the best thing for the investor. It's structured many times at what's the best thing for the mutual fund company to make the most money.

PAUL SOLMAN: Also dropping by: financial planner Ernie George. He wasn't surprised that investors are only starting to become upset.

ERNIE GEORGE: They have no idea what the cost has been to them.

PAUL SOLMAN: None?

ERNIE GEORGE: I really don't. We've had very few calls from clients. They read it in the newspaper. They don't think it affects them. And I think they will continue to be upset as more and more information comes out in the current investigations that are ongoing.

PAUL SOLMAN: Meanwhile, back in court...

MERCER BULLARD: Now another count in this indictment is based on what's known as "late trading." It's kind of a... a poor cousin, you might say, of stale prices. Late trading occurs when the price of the fund may be perfectly accurate at 4:00 p.m., Eastern time.

PAUL SOLMAN: But then, after trading closes, Microsoft, let's say, declares a huge dividend.

MERCER BULLARD: And you all are sitting here thinking, "Boy, I wish I could have bought Microsoft at the 4:00 price. Too bad I can't."

PAUL SOLMAN: But if you're an insider in cahoots with a self-serving mutual fund manager, you can.

MERCER BULLARD: Knowing that, how much it's worth now at 5:00 or 6:00 or even as late as 9:00, as stated in this indictment, and you get that fund priced at the Microsoft 4:00 p.m. price, it's like, as New York Attorney General Spitzer said, it's like betting on a horse race, or after it's over, or betting on the flip of a coin after you've seen whether it's heads or tails.

ELIOT SPITZER: It was a tale that was so outrageous at first, that we didn't believe it.

PAUL SOLMAN: Eliot Spitzer was tipped off by an industry executive last spring, after he'd become known for going after Wall Street analysts pushing stocks they didn't believe in.

ELIOT SPITZER: At its core, that's corrupt. Just as bad is what some of the mutual funds have been permitted, which amounts to an enormous transfer of wealth from your long-term investors, mom-and-pop investors to the highly sophisticated, whether they're hedge
funds or others who were trading in and out, taking advantage of the game and the mutual funds. And others have permitted this. Why? Because they got some extra money.

PAUL SOLMAN: How exactly does the small investor get hurt?

PAUL SOLMAN: When these sophisticated players go in and extract some of this profit, whatever dollar they take out otherwise would have stayed there and gone back to the longer-term investor.

MERCER BULLARD: And that adds up to real money-- hundreds of millions extracted through these two maneuvers alone. And then there's a third one. Funds promise investors that they don't allow short-term traders to buy and sell shares. It's going to hurt you. It's going to hurt our returns and raise our costs. We are going to stop them at the door and tell them to go home. Well, in fact, these funds not only did not stop them at the door, they invited them in with open arms.

PAUL SOLMAN: So short-term traders, too, were allowed to make money off the fund's other investors.

MERCER BULLARD: So now we've gone over three counts, and you've probably perceived that there is a common theme. The common theme is that each of these frauds involves advantaging the big hedge fund manager who has the connections and disadvantaging the mom and pop long-term investor who's just struggling to try to establish their lifetime financial security.

PAUL SOLMAN: Like the mock jurors themselves.

JOANNE GABRYNOWICZ, Law Professor: I'm beginning to wonder if... what are the advantages of being in a mutual fund; that I might be better off just investing my money and avoiding the mutual funds if that's the way my account is going to be handled.

TONY WALKER: Mutual funds have become the alternative to pension funds for a lot of people. And if we can't trust that they're going to be what they're supposed to be, that will have a long-term impact on the well-being of the society as a whole. We're using these to plan for our old age, and that's a very serious issue.

PAUL SOLMAN: As to the jury's verdict.

WOMAN: I believe my trust has been violated by the mutual fund managers. Whether or not that's criminal, I believe they have violated the trust, and it's unethical.

PAUL HAAGA: If we don't have the investors' trust, we don't have anything.

PAUL SOLMAN: Trust is also a very serious issue to the mutual fund industry, says Paul Haaga, chairman of a fund industry trade group. All of the mutual funds we contacted declined our requests for interviews, and referred us to him instead.
PAUL HAAGA: When we first heard about this, we were outraged, very surprised, shocked, particularly by the late trading. And to hear that it's not just one, but several violations, I think that's also why you will not hear us arguing about whether this was three bad apples at three fund firms. Anytime there is... there are misdeeds that affect our shareholders of violations of the law, of violations of the principles that shareholders come first, we're going to fix it. And to the extent that trust has been eroded by the actions of a few, the many in the fund industry are going to work as hard as we can to get that trust back.

PAUL SOLMAN: To that end, Haaga's group has proposed three reforms: A firm 4:00 p.m. deadline for all trade orders; a mandatory redemption fee of at least 2 percent on short-term trading; and more scrutiny of trades by fund executives for their own accounts, because investor skepticism is beginning to grow even down at the grove.

RANDY FRAZIER: I do worry about the conflicts of interest. At this point, I just have faith in my fund administrator, my current fund administrators.

PAUL SOLMAN: Do you have any reason to have that faith?

RANDY FRAZIER: No, no.

PAUL SOLMAN: In the end, if even a savvy law student thinks he doesn't have grounds for faith, one wonders how the rest of us should feel.