

Fund industry swats down fee suits, but they keep appealing

Many of the cases concentrate on subadvisor fees

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Mutual funds continue to swat down excessive fee cases, but they're still making it into court, which could mean that plaintiffs just haven't filed the best case yet.

The most recent cases involve subadvisory fees, where fund companies farm out the actual work of portfolio management to another company. For example, a fund might charge a 0.75% management fee to shareholders, yet pay the subadviser 0.25%. The plaintiffs' argument: The fund company does precious little for the 0.5% it pockets.

"That's excessive on a prima facie basis," said Niels Holch, executive director of the [Coalition of Mutual Fund Investors](#) and partner at Holch & Erickson LLP, a Washington, D.C. law firm.

Not surprisingly, the mutual fund industry takes a different view of the cases, which cite section 36(b) of the Investment Company Act of 1940. The section provides that the investment adviser of a registered investment company "shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services," and expressly provides shareholders with the right to bring a lawsuit to enforce this duty.

The standard for compliance with section 36(b) is the Gartenberg standard, set by the Supreme Court in a landmark 2010 decision, *Jones v. Harris Associates, L.P.* "To be guilty of a violation of §36(b), ... the adviser–manager must charge a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's–length bargaining." The fund industry feels that the charges in the recent cases, such as one against the Hartford funds, are baseless.

Mr. Holch isn't so sure. While the subadvisory bidding process is typically an arm's-length transaction, the division of the advisory fee sometimes isn't, he said. And, although the cases haven't been successful, they have fended off motions to dismiss, and several, such as the Hartford case, are currently under appeal.

And the funds' arguments that their share of the advisory fee covers the many costs of maintaining a fund and its client relationships may not hold, either, Mr. Holch notes. "It's a red herring. Advisory fees are separate from the many other fees a fund charges, such as transfer fees and 12-b(1) fees to brokers," he said.

While fund boards do have oversight duties over subadvisers, those costs are typically not large. "Shareholders have to ask, 'What are we paying for oversight?'" Mr. Holch said. Among the cases currently active:

- [Kasilag](#) v. Hartford Inv. Fin. Serv., LLC, under appeal
- [Sivolella](#) v. AXA Equitable Life Ins. Co., under appeal
- In re [BlackRock](#) Mut. Funds Advisory Fee Litigation, in discovery

[ICI Mutual](#), which insures funds against lawsuits, has paid \$924 million in claims as of the end of 2016.