A Flurry of Stories on Mutual Fund Fees

Posted on Thursday, August 20th, 2009 at 7:00 am.

Over the last few days there has been renewed interest in the upcoming Supreme Court case that will should rule on the fees charged by mutual funds. Back in May, I published Supreme Court to Decide on Investment Company Act Case after they agreed to hear *Jones v. Harris Associates, L.P.* I didn't expect much mainstream press coverage of the case until the decision comes out next winter.

Over the weekend, Wall Street Journal columnist Jason Zweig published Can the Supreme Court Undress High Fund Fees? which pointed out that this case will "hit you right in the pocket." Then The New York Times ran Supreme Court to Hear Case on Executive Pay which portrayed the as one focused on out of control executive pay. It sounds like the press has figured out that the case could have some broad implications on the way mutual funds decide what fees to charge.

Under §36(b) of the Investment Company Act of 1940 the "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, or of payments of a material nature, paid by such registered investment company."

The traditional standard was that a breach of fiduciary duty occurs when the adviser charges a fee that is "so disproportionately large" or "excessive" that it "bears no reasonable relationship to the services rendered and could not have been the product of arm's-length bargaining." *Gartenberg v. Merrill Lynch*, 694 F.2d 923 (2nd Cir. 1982)

The *Jones v. Harris* case starts with the claim that the fees are excessive because they far exceed those charged to independent clients. Like many investment advisers, Harris charges less for institutional clients that invest in funds similar to its Oakmark funds. The plaintiffs take the position that a fiduciary should not charge a different price to its controlled clients than it does to its independent clients.

Certainly, mutual funds rarely fire their advisers. But investors do fire the advisers by moving their money to different mutual funds and investments.The decision is likely to focus more on the procedure for setting fees than the absolute value of the fees.

It sounds like this case is getting tarted up as a blast against executive compensation. But really, its about the dense language in the Investment Company Act, fiduciary duty and compliance. Since the decision could have a broad impact on lots of peoples' investments, it will likely get lots of coverage at the oral arguments on November 2, 2009 and whenever the decision comes out.

References:

- Can the Supreme Court Undress High Fund Fees? by Jason Zweig for the Wall Street Journal
- Supreme Court to Hear Case on Executive Pay by Adam Liptak for The New York Times
- The Emergence of Jones v. Harris by William Birdthistle on The Conglomerate
- Investment Indiscipline: A Behavioral Approach to Mutual Fund Jurisprudence by

William Birdthistle

- Seventh Circuit Court of Appeal Decision in Jones, et al., v. Harris Associates (.pdf)
- Petition for certiorari (.pdf)

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