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Life and Annuity Series: Excessive Fee Cases

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Below is an update on the "excessive fee" cases under section 36(b) of the Investment Company Act of 1940.

Most of these complaints are now proceeding on the "sub-adviser" theory: that annuity contract-holders pay "excessive fees" in violation of the' 40 Act when the insurer (or its affiliate) acts as the "adviser" for the investment options in the contracts, and delegates investment advisory and portfolio management services to an unaffiliated "subadviser." According to the complaints, these sub-adviser arrangements essentially result in an overall "excessive fee" (i.e., one that bears no reasonable relationship to the value of the services rendered) because the insurer (or its affiliate) is paid a large fee for doing little work.

These complaints have been filed against several insurance companies or their affiliates (AXA, State Farm, New York Life, ING, Hartford, and Principal), as well as against investment advisers not affiliated with insurers. (*See* the case examples listed below.) Many of the motions to dismiss these cases as a matter of law have been denied. Most recently, the New Jersey federal court denied AXA Equitable's motion for summary judgment, and set the case for trial, in an order that did not contain any reasons for its decision. A different judge in New Jersey federal court denied Hartford's notion to dismiss, holding that there was a "plausible inference" that Hartford's charges as the adviser were excessive because they were allegedly three times more on average than the amounts that Hartford paid to sub-advisers for the same services, and compared unfavorably to lower cost providers like Vanguard.

The court decisions addressing these types of complaints are instructive for what they do not say. They do not focus on the heavy burden of the plaintiff to show, as required by the Supreme Court's 2010 decision in *Jones v. Harris Associates*, that the challenged fee must be "so disproportionately large that it bears no reasonable relationship to the services rendered .... " Nor do the decisions focus on the Supreme Court's admonition that the courts should defer to the fund boards' approval of fee arrangements, and not engage in judicial second-guessing. Instead, many of the courts have concluded that sub-adviser relationships create the potential for a claim where the adviser is taking a large share of the fee compared to the sub-adviser or compared to other low-cost providers of

funds. This relatively low barrier in turn has prompted more lawsuits to be filed.

The proposed Department of Labor "conflict of interest" rule could increase the uncertainty caused by these lawsuits when they involve retirement assets. For example, it is unclear whether the DOL's rule defining "reasonable compensation" will incorporate the factors adopted by the Supreme Court in *Jones v. Harris* for investment adviser firms, or create separate standards for whether "excessive fees" have been received by an insurer and any of its related investment adviser affiliates. Will the excessive compensation rules be applied by investment option under the '40 Act, or applied by product under the DOL rule? What excessive fee standard will apply if the same investment option is used in retirement products that are covered by the DOL Rule and other products that don't fall under the rule? Will fees be "excessive" for some investors and not others? The answers are not clear.

Excessive Fee Cases Against Insurers or Their Affiliates

- *Sivolella v. AXA Equitable*, Civil Action No. 3:11-cc-04914 (D.NJ 2015) (motion for summary judgment denied)
- *Ingenhutt v. State Farm Investment Mgmt Corp.*, 1:15-cv-01303 (C.D. ill 2014) (complaint filed)
- *Redus-Tarchis v. New York Life Investment Mgmt*, Case 2-14-cv-07911 (D.NJ 2104) (complaint)
- *Cox v. ING Investments*, Case 1:B·cv-01521 (D. Del) (complaint)
- *Kasilag v. Hartford Investment Financial Services*, 1:11-cv-01083 (D.NJ) (motion to dismiss excessive fee claim denied)
- *Curran v. Principal*, No. 09-433 (S.D. Iowa) (motion to dismiss granted on lack of standing)
- *Am. Chem. Equipment v. Principal*, No. 13-601 (N.D. Ala.) (complaint)

Excessive Fee Cases Against Advisers Not Affiliated With Insurer

- *In re Blackrock Mutual Funds Advisory Fee Litigation*, Civil Action No. 14-1165 (D. NJ) (motion to dismiss denied)
- *Goodman v. J.P. Morgan Investment Management*, Case No. 2:14-cv-414 (S.D. Ohio) (motion to dismiss denied)
- *Curd v. SEI International Equity Fund*, Civil Action No. 13-7219 (E.D. Pa.) (motion to dismiss denied)
- *Zehrer v. Harbor Capital Advisors*, Case No. 1:14-cv-00789 (N.D. lll) (motion to dismiss denied)
- *Turner v. Davis Select Advisers*, Case 4:08-cv-00421 (D. Az) (motion to dismiss granted)
- *Hebda v. Davis Select Advisers*, Case 1:14-cv-04318 (S.D.N.Y.) (complaint)
- *McClure v. Russell Investment Mgmt*, 1:13-cv-12631 (D. Ma.) (complaint)
- *Chill v. Calamos Advisors*, 1:15-cv-01014 (S.D.N.Y.) (complaint)
- *In re American Mutual Funds Fee Litigation*, Case No. CV 04-5593 (C.D. Cal.) (Court found after trial that plaintiff had failed to prove an excessive fee)

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