ICI MUTUAL **NEWSLETTER**

Claims Trends

Review of 2010 Claims Activity in the Mutual Fund Industry

ICIMutual
A Risk Retention Group

Abbreviations used in this *Claims Trends*:

'33 Act	Securities Act of 1933
'34 Act	Securities Exchange Act of 1934
Dodd-Frank	Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010
ERISA	Employee Retirement Income Security Act of 1974
FINRA	Financial Industry Regulatory Authority
IAA	Investment Advisers Act of 1940
ICA	Investment Company Act of 1940
RICO	Racketeer Influenced and Corrupt Organizations Act
SEC	U.S. Securities and Exchange Commission
SLUSA	Securities Litigation Uniform Standards Act of 1998

In addition, U.S. Courts of Appeals are referred to by their circuit number (e.g., First Circuit, Second Circuit).

Introduction

Since 1999, ICI Mutual has issued *Claims Trends,* an annual report on significant litigation, regulatory proceedings and operational errors affecting the fund industry. The publication is designed to assist ICI Mutual's insureds in better assessing and managing the risks associated with such matters, thereby reducing the potential for associated losses and reputational damage.

ICI Mutual measures claims activity both by frequency and by severity. Following an unprecedented increase in claims frequency during the mutual fund trading scandal period of 2003-04, *frequency* has returned in recent years to longer-term historical norms. Even so, the annual number of reported claims remains substantial. In 2010 alone, more than one quarter of all fund groups insured under ICI Mutual directors and officers/errors and omissions (D&O/E&O) policies submitted at least one new claim notice. During the three-year period 2008-10, approximately one half did so.

The *severity* of new claims can be more difficult to measure. In certain claims—such as "costs of correction" claims, in which insureds seek insurance recovery for payments made by them to correct operational errors for which they are legally responsible—the magnitude of losses can often be quickly and precisely established. However, for many claims—including shareholder class action lawsuits, other types of civil litigation, and SEC and other regulatory actions—the magnitude of losses that may ultimately be sustained by insureds (whether in the form of judgments, settlements, and/or associated defense costs) may not be finally determined for a number of years.

Even so, recent events evidence that severity remains a significant threat in today's claims environment. The past year has witnessed two of the largest shareholder class action settlements in fund industry history (each involving a payment in the nine figures), along with one of the larger "costs of correction" payments ever made by a fund adviser.

Meanwhile, the cost to fund groups of defending against litigation and regulatory actions remains high. In arbitrations and other relatively small-scale matters, defense costs can reach mid-six to low-seven figures. In more substantial regulatory investigations and shareholder litigation, defense costs can quickly climb into mid-seven and even eight figures.

It is too early to assess the impact on future claims frequency and severity of recent legislative and regulatory developments, including the enactment of "whistleblower" provisions under Dodd-Frank, and the adoption by the SEC's Division of Enforcement of new initiatives that focus specifically on asset managers and mutual funds. Some industry observers have predicted that these developments may lead to a future increase in the number of regulatory investigations (whether formal or informal) and regulatory actions involving the fund industry. Observers have also suggested new regulatory claims, if and as they occur, could spur follow-on civil litigation by "the plaintiffs' bar"—private lawyers who specialize in pursuing large-scale recoveries on behalf of investors against financial institutions and other large corporations.

Whatever the future may hold, key risks for fund groups in the current environment, as in past years, include: (1) *disclosure* claims—i.e., lawsuits challenging the accuracy or adequacy of disclosures made by funds and advisers; (2) *fee* claims—i.e., lawsuits challenging fees received by investment advisers and other service providers; (3) *regulatory* claims—i.e., investigations, administrative proceedings and/or litigation initiated by the SEC or other federal or state authorities; and (4) liabilities for *operational errors*—i.e., legal obligations that may arise from errors committed by advisory personnel or other individuals or entities in the portfolio management process.

This edition of *Claims Trends* reports on recent developments in each of these four risk areas. This edition also reports on other noteworthy claim developments during 2010 and early 2011, including a renewed effort by the plaintiffs' bar to target fund advisers and fund directors in civil litigation alleging violations of state (rather than federal) law.

Disclosure

A major source of potential liability for funds and their directors, officers, advisers, and principal underwriters is the "prospectus liability" class action lawsuit brought under the '33 Act, alleging inaccurate or incomplete disclosure in a fund's prospectus and/or statement of additional information. Readers are referred to ICI Mutual's 2010 risk management study, *Mutual Fund Prospectus Liability* (available at www.icimutual.com), for a general introduction to '33 Act class action lawsuits, and for details regarding the fund industry's experience with such litigation.

Subprime/Credit Crisis Litigation

As reported in prior *Claims Trends*, in 2007-08, financial institutions experienced a sharp increase in litigation arising from the collapse of the subprime mortgage market and the credit crisis. With the easing of the credit crisis in 2009, the pace of new filings declined. Even so, during this period 2007-09, individual funds in eight fund groups became the focus of major shareholder class action lawsuits alleging violations of the '33 Act (and, in some cases, alleging other legal violations as well).

Spearheaded by the plaintiffs' bar and filed in federal courts, these lawsuits challenge the adequacy of the disclosure provided by "outlier" fixed-income funds whose performance during the subprime/credit crisis period was well below that of their peers. The plaintiffs in these lawsuits, purportedly acting on behalf of larger "classes" of fund shareholders, seek to hold funds and fund advisers—and, in some cases, fund directors, officers and principal underwriters—liable for misrepresentations and omissions allegedly made with respect to the nature and types of securities that were held by the funds. The lawsuits seek monetary recovery for the associated investment losses sustained by fund shareholders.

Most of these subprime/credit crisis lawsuits have now moved beyond the early, pre-trial stage of litigation known as the *motion to dismiss,* where defendants challenge the adequacy of plaintiffs' allegations and petition the court to terminate a lawsuit on purely legal grounds. To date, federal trial courts have ruled on motions to dismiss for six of the eight fund groups. In five cases, the courts denied the defendants' motions (in whole or in part), thereby permitting the lawsuits to move ahead in the litigation process.[1]

Thus far, the motion to dismiss of only one fund group has been granted in its entirety. A federal trial court first dismissed this lawsuit in early 2010 (on the grounds that the challenged disclosures were not misleading), and the plaintiffs thereafter amended their allegations to seek to address the deficiencies identified by the court. In March 2011, the court again dismissed the lawsuit, ruling, in effect, that any misstatements or omissions in the fund's disclosure could not themselves have *caused* the plaintiffs' alleged losses.[2] The court's rationale, if widely adopted, could impair future efforts by the plaintiffs' bar to pursue '33 Act claims against mutual funds, fund directors and fund advisers. At the time this *Claims Trends* went to press, it was not yet clear whether the plaintiffs would appeal this dismissal.

In '33 Act shareholder class actions involving mutual funds, as in securities class actions generally, lawsuits that survive motions to dismiss are frequently resolved—sooner or later, and in any case prior to trial—by agreement of the parties (and often with a sizeable settlement payment by one or more defendants and/or their insurers). To date, settlements have been reached by two of the five fund groups whose motions to dismiss were denied. One settlement involves a payment of over $200 million, and the second involves a settlement payment in the mid-seven figures. Both settlements have been preliminarily approved by the respective courts.

Exchange Traded Funds

Last year's *Claims Trends* reported on new '33 Act class action litigation targeting leveraged ETFs. These lawsuits focus on the adequacy of prospectus disclosure relating to compounding, leverage, resets, and other attributes of the funds' investment strategies. Although not an ETF, an inverse fund has also been named in a similar lawsuit.

In early 2011, a motion by defendants to dismiss the lawsuit involving the inverse fund was in large part denied by a federal trial court.[3] A motion to dismiss one of the ETF lawsuits has been filed, but has not yet been ruled upon by the court. Meanwhile, a second ETF lawsuit remains in its early stages, with a consolidated complaint filed by the plaintiffs in late 2010.[4]

Other Disclosure-Based Litigation

Shareholders generally have two legal avenues to challenge mutual fund disclosure in a class action: the '33 Act (as discussed above) and the '34 Act (and, more specifically, section 10(b) of the '34 Act and rule 10b-5 thereunder). Securities class actions in the public company context are more commonly brought as rule 10b-5 "securities fraud" lawsuits under the '34 Act, whereas class actions in the mutual fund context are more commonly brought as "prospectus liability" lawsuits under the '33 Act.[5]

In part, this distinction can be explained by the fact that shareholders who sue under rule 10b-5 are subject to various legal requirements that can be difficult to satisfy in the mutual fund context, including the requirement to demonstrate that defendants engaged in intentional or reckless misconduct (i.e., "scienter"). At certain pre-trial stages of the litigation process, fund industry defendants typically petition courts to terminate rule 10b-5 lawsuits, on the grounds that one or more of these legal requirements have not been met.

Fund industry defendants continue to enjoy considerable success in their pre-trial challenges to rule 10b-5 lawsuits. In 2010, federal trial courts granted motions to dismiss rule 10b-5 claims in two class action lawsuits involving auction-rate preferred securities and subprime/credit crisis issues, respectively.[6] A third federal trial court granted a fund group's motion for summary judgment in a long-standing rule 10b-5 class action lawsuit that arose out of the market timing scandal of 2003-04.[7] In each of these cases, the courts found that the plaintiffs had failed to make a demonstration of scienter sufficient to permit their 10b-5 claims to survive.

However, fund industry defendants in rule 10b-5 lawsuits are not always successful in their pre-trial challenges. In 2010, the Second Circuit reversed and remanded for further consideration a federal trial court's dismissal of rule 10b-5 claims in a lawsuit alleging that a fund adviser made false and misleading statements regarding a contract for transfer agency services for its managed funds.[8]

As this issue of *Claims Trends* went to press, the fund industry was awaiting a decision by the U.S. Supreme Court in another rule 10b-5 lawsuit involving a fund adviser.[9] No mutual funds or mutual fund shareholders are parties to this litigation. Rather, the lawsuit is a "parent company" case, brought on behalf of shareholders of the publicly traded parent company of a mutual fund investment adviser. The lawsuit, which originated during the mutual fund scandal period of 2003-04, charges the adviser and its parent company with deceptive disclosure in mutual fund prospectuses regarding steps being taken to address market timing in the funds. The lawsuit seeks to hold the defendants liable under rule 10b-5 for the diminution in market value of shares of the parent company that purportedly resulted from the allegedly deceptive disclosure.

In its forthcoming decision, the Supreme Court is expected to address the issue of when, if ever, an investment adviser who participates in the drafting and/or dissemination of a fund prospectus can be deemed to have "made" any misstatements therein, so as potentially to be at risk for liability in shareholder litigation brought under rule 10b-5. The case is being closely watched in the broader corporate sector, due to the possible impact of the Court's decision on the rule 10b-5 litigation exposure of a broad range of service providers to public corporations (e.g., accounting firms, law firms).

Whatever the impact of the Court's decision may be on rule 10b-5 class action litigation in the broader corporate sector, some observers have suggested that the impact on rule 10b-5 litigation brought by *mutual fund* shareholders may be, at least as a practical matter, relatively modest. Among other things, these observers note that nothing in the Court's decision is likely to change various of the hurdles (including the scienter requirement) that currently face the plaintiffs' bar in pursuing rule 10b-5 lawsuits on behalf of mutual fund shareholders.

Fees

Section 36(b) of the ICA 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 affords shareholders the right to bring a lawsuit to enforce this duty.[10]

Fees have also been the subject of scrutiny outside the section 36(b) context, including in litigation brought under ERISA and derivative claims brought under state law for breach of fiduciary duty, and have recently received renewed attention by industry regulators.

Section 36(b)

In March 2010, as reported in last year's *Claims Trends*, the U.S. Supreme Court issued a decision in *Jones v. Harris Associates, L.P.*, in which the Court affirmed the longtime "*Gartenberg* standard" as the appropriate measure of liability under section 36(b).[11]

Numerous federal trial courts and appellate courts are now being called upon to consider the impact of the Court's ruling on pending section 36(b) lawsuits—i.e., on those lawsuits that were in progress (or on appeal) at the time that *Jones v. Harris* was decided. At the time this *Claims Trends* went to press:

- the *Jones v. Harris* lawsuit was itself back before the Seventh Circuit for further consideration;[12]

- a companion lawsuit to *Jones v. Harris* was again on appeal to the Eighth Circuit (following a second, post-*Jones v. Harris* dismissal of this companion lawsuit by a federal trial court);[13]

- two other section 36(b) lawsuits were nearing trial, with one reportedly likely to be resolved through settlement;[14]

- another lawsuit had survived a post-*Jones v. Harris* decision on the defendants' motion to dismiss;[15] and

- appeals from pre- and post-*Jones v. Harris* trial court decisions remained pending before federal appellate courts.[16]

Meanwhile, the plaintiffs' bar has initiated only three *new* section 36(b) lawsuits since the Supreme Court's ruling of a year ago. One of these lawsuits targets a fund adviser, fund distributors, and certain affiliated insurance companies. Filed the day after the Court's decision in *Jones v. Harris*, the lawsuit is unusual in that it combines an ICA section 36(b) claim with claims of ERISA violations. The defendants' motion to dismiss is pending.[17]

The remaining two cases, filed in late 2010 and early 2011, respectively, are more typical. Both lawsuits name the same defendant—the adviser/principal underwriter for a family of funds—and challenge as excessive the investment management and rule 12b-1 fees received by the defendant. Among other things, the plaintiffs focus on the alleged disparities between (1) the defendant's advisory fees and the fees paid to its "subcontractors" (i.e., subadvisers), and (2) the advisory fees paid to the defendant by managed funds and the fees paid by the defendant's institutional accounts. In one of these cases, the defendants have filed a motion to dismiss, which is pending.[18]

Over time, developments in the matters described above may bring greater clarity to the section 36(b) landscape. In the interim, the long-term impact of the Supreme Court's decision in *Jones v. Harris* remains to be seen.

Other Developments in Fee Litigation

Outside the context of ICA section 36(b), fee payments have also been subject to challenge by the plaintiffs' bar under other legal theories involving different provisions of federal or state law.

Last year's edition of *Claims Trends* reported on one such challenge, in a lawsuit involving a financial institution's sale of its fund advisory business to another firm. That case, filed against the trustees of the affected funds, charges (among other things) that the board breached its fiduciary duty under state law, by "fail[ing] to avail itself of the opportunity presented to seek to negotiate lower fees" on behalf of the fund. The trial court's dismissal of the lawsuit remains on appeal.[19]

In three lawsuits filed in 2009 and 2010, the plaintiffs' bar has challenged rule 12b-1 distribution fee payments under provisions of the ICA other than section 36(b). More specifically, these lawsuits allege that payments by mutual funds of "non-transactional asset-based compensation" to broker-dealers in connection with fund shares held in brokerage accounts violate provisions of the ICA and the IAA, so as to render the funds' distribution contracts unenforceable under ICA section 47(b). In 2010, a federal trial court dismissed one of these lawsuits for a second time, in a ruling that is now on appeal to the Ninth Circuit.[20] In March 2011, another federal trial court dismissed a second of these lawsuits, and it was not yet clear, at the time this *Claims Trends* went to press, whether the plaintiffs would appeal.[21] A motion to dismiss the third lawsuit remains pending.[22]

Regulatory Claims

2010 and early 2011 witnessed continued scrutiny of asset management activities by the SEC and other regulatory authorities. Regulators focused much of their attention on hedge fund managers and other actors outside the regulated investment company area. Yet the fund industry was by no means immune, with regulatory probes, investigations, and/or actions initiated (or continued) with respect to various issues, including insider trading, valuation, and disclosure. Certain of these regulatory enforcement matters have focused on underlying events that are the subject of concurrent civil litigation brought by the plaintiffs' bar. [23]

Dodd-Frank and other developments over the past year have led some observers to predict an increase in SEC enforcement activity involving the fund industry. In September 2010, in an appearance before the U.S. Senate Committee on the Judiciary, the director of the SEC's Division of Enforcement advised that the Division's new asset management unit was developing several initiatives "targeting disclosure, performance and valuation by funds and their advisers," including a "mutual fund fee initiative," a "bond fund initiative," and a "problem adviser" initiative. The director testified that the initiatives will involve the development of "analytics" that "are expected to result in examinations and investigations of investment advisers and … boards of directors concerning duties under the [ICA]."[24]

Observers have suggested that future regulatory claims, if and as they occur, could spur the plaintiffs' bar to initiate new litigation against the fund industry. As evidenced by the industry's experience during the mutual fund scandal period of 2003-04, the plaintiffs' bar often seeks to utilize allegations or findings in public regulatory claims as a basis for "follow-on" civil litigation seeking monetary recoveries on behalf of funds or fund shareholders.

Portfolio Management Errors

Portfolio management and other operational errors continue to represent a significant portion of insurance payments made by ICI Mutual. Since its formation in 1987, ICI Mutual has paid over $95 million in "costs of correction" claims—i.e., insurance claims involving payments made by advisers, outside the litigation context, to remedy operational errors that have adversely impacted their managed funds or private accounts.

Whether measured in terms of frequency or severity, costs of correction claims reported to ICI Mutual have disproportionately involved private accounts, particularly in recent years. More specifically, over the past five years, errors in the management and servicing of private accounts have accounted for two thirds of all costs of correction claims received by ICI Mutual, and approximately 65% of all amounts paid by ICI Mutual on such claims. In recognition of these facts, ICI Mutual recently published a new risk management study, *Managing Operational Risks of Private Accounts* (available to all ICI Mutual insureds at www.icimutual.com). The study is designed to assist fund groups in their review and discussion of techniques and procedures for reducing these risks.

Of course, operational errors are not limited to private accounts. Mutual funds may also be adversely impacted by an adviser's failure to follow investment guidelines, trading errors, mistakes in processing corporate actions, and the like. In 2010, in one of the largest costs of correction claims ever reported to ICI Mutual, an adviser made an eight-figure payment to certain of its managed mutual funds to compensate for losses incurred by the funds as a result of the adviser's operational error.

This loss history demonstrates the importance to fund groups of close attention to policies, procedures and the use of technology designed to prevent and detect operational mistakes and oversights.

This loss history also underscores the continuing value to the fund industry of the "costs of correction" insurance coverage pioneered by ICI Mutual. Generally, under this coverage, an insured adviser or other service provider may be reimbursed for costs incurred to correct an operational error, so long as the adviser or other service provider has actual legal liability for the resulting loss.[25]

Other Litigation Developments

In addition to the disclosure- and fee-based cases already discussed, last year also saw several other noteworthy claim developments, including the following.

Derivative Actions and the Plaintiffs' Bar

Litigation challenges to fund advisers and fund directors sometimes take the form of *derivative actions*—i.e., lawsuits filed by the plaintiffs' bar, ostensibly on behalf of funds themselves, rather than on behalf of individual shareholders or "classes" of shareholders. One of the non-section 36(b) fee-based lawsuits discussed above is structured in this way.[26] But as discussed below, there has been a recent trend by the plaintiffs' bar to seek to utilize derivative actions in other areas as well.

In part, this trend towards the use of derivative actions may reflect the fact that legal avenues available to the plaintiffs' bar for attacks on the fund industry have narrowed in recent years. In particular, the courts, in a number of decisions, have refused to find "implied" rights of action under various provisions of the ICA. 2010 saw additional decisions favorable to the industry in this regard, as the Ninth Circuit ruled that there is no private right of action under ICA section 13(a) (i.e., shareholders may not sue directly for alleged violations of that section), and a federal trial court ruled that there are no implied private rights of action under ICA sections 13, 22, 30, and 34(b).[27]

A derivative action is typically preceded by a "shareholder derivative demand" made by a plaintiff's law firm on behalf of a fund shareholder. The shareholder derivative demand calls on the fund board to authorize and pursue litigation, on behalf of the fund, against the fund's adviser and/or the fund's officers or directors, in order to remedy the alleged violation(s) of law. A thorough and effective investigation by a fund board of a shareholder derivative demand can reduce the risk that any subsequent derivative action that may be pursued by the plaintiff's law firm will be successful. A fund may incur significant costs in conducting an appropriate investigation of a shareholder derivative demand, and ICI Mutual has responded by automatically providing specialized insurance coverage to defray such costs.[28]

Auction-Rate Preferred Securities

In 2008-09, holders of ARPS filed a handful of lawsuits against funds, fund officers and directors, and/or fund advisers. These lawsuits, founded on various legal theories, appear to have been designed, at least in part, to secure liquidity for ARPS holders. Most of the lawsuits have since been discontinued on agreement by the parties, and only one appears to remain active.[29]

In 2010, after numerous funds had redeemed outstanding ARPS and implemented alternative forms of financing, the plaintiffs' bar initiated a new wave of ARPS-related lawsuits against at least nine fund groups. As discussed below, these lawsuits take two basic forms, but in each the basic premise is the same—that fund group defendants breached their fiduciary duties by authorizing or participating in the redemption of ARPS in favor of new, allegedly less favorable financing, to the detriment of fund common shareholders.

Lawsuits against six of these fund groups take the form of derivative actions. Filed in state courts, lawsuits in this category target ARPS fund advisers (and, in some cases, their parent companies), as well as interested directors and executive officers of the funds. Fund independent directors are *not* named as defendants, and the funds themselves are named only as nominal defendants. These cases remain in their early stages of development. To date, one such lawsuit has been dismissed.[30]

Lawsuits against three fund groups are structured as purported class actions—i.e., actions brought on behalf of "classes" of common shareholders, rather than on behalf of the funds themselves. These lawsuits name fund directors, including independent directors, as defendants, along with the funds themselves, and the funds' investment advisers (and, in some cases, their parent companies). Most of these lawsuits were originally filed in federal courts, before being voluntarily withdrawn for procedural reasons. The lawsuits were subsequently re-filed in *state* courts, where most remain pending.

In March 2011, in the first ruling on a motion to dismiss in this "state law class action" category of ARPS lawsuits, a federal trial court dismissed one such lawsuit as barred by SLUSA. The plaintiffs have filed a notice of appeal to the Seventh Circuit.[31]

Fund Investments in Gambling Industry Securities

Past *Claims Trends* reported on a series of lawsuits, filed in federal courts beginning in 2008, that advanced a novel theory of civil liability—that fund investments in online gambling companies constituted illegal racketeering, in violation of RICO. In 2009, a federal appeals court affirmed a federal trial court's dismissal of one of these lawsuits, holding that plaintiffs had failed to show (as required) that the fund group's alleged racketeering had itself *caused* the shareholders' injuries.[32] Most of the remaining lawsuits were likewise dismissed in 2009 and 2010.

The plaintiffs in these dismissed cases have since re-filed their lawsuits in state courts. The plaintiffs' lawyers have recast their lawsuits as derivative actions, based on essentially the same activities, but alleging violations of state law (e.g., breach of fiduciary duty and waste). These reformulated lawsuits remain in their early stages, with defendants' motions to dismiss yet to be ruled upon by the courts.

Bankruptcy Claims by Issuers of Portfolio Securities

In litigation brought under federal bankruptcy laws, bankrupt companies (or their creditors) often seek a return of pre-bankruptcy debt payments made to debt holders or other creditors. In recent years, a number of these proceedings have involved mutual funds, typically for no reason other than the funds' status as passive holders of the debt securities at issue.

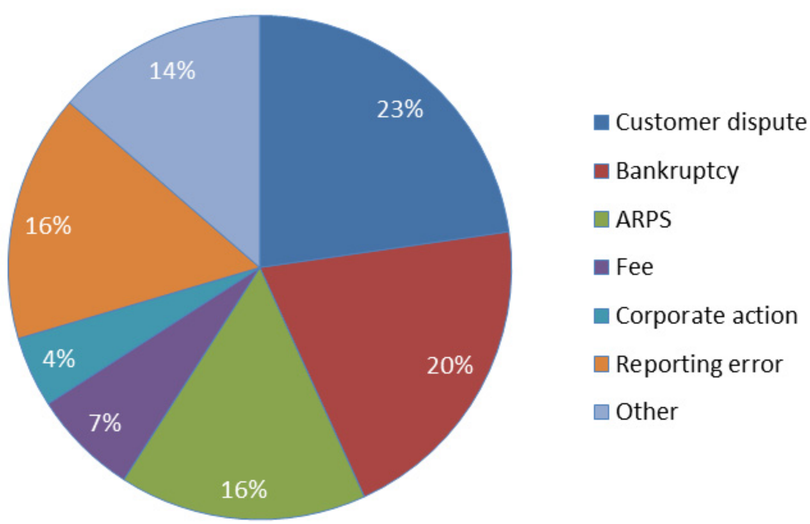
In 2010, the Second Circuit upheld the dismissal from bankruptcy litigation of a number of mutual funds involved in the Adelphia Recovery Trust bankruptcy proceeding. Most recently, in late 2010 and early 2011, new bankruptcy proceedings (including a proceeding for the Tribune Company) have included a number of funds as parties.

D&O/E&O Claims Data

D&O/E&O Notices – 2010

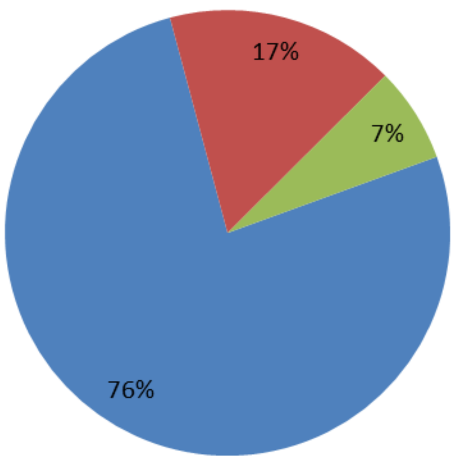
The most common subject matters in claims notices provided under ICI Mutual D&O/E&O policies in 2010 included (1) customer disputes (i.e., disputes between insureds and individual customers, including individual fund shareholders and separately managed accounts, regarding various investment management or account administration matters); (2) bankruptcy proceedings; and (3) lawsuits relating to ARPS funds. (See generally pp. 8-9 of this *Claims Trends*.)

D&O/E&O Notices by Subject (2010)



D&O/E&O Insurance Payments by Category (2001-10)

The first chart below shows the breakdown of payments (i.e., defense costs, settlements and judgments, and costs of correction) made by ICI Mutual on claims submitted over the past ten years under ICI Mutual D&O/E&O policies. The second chart shows the same information, but *excludes* payments made on insurance claims associated with the mutual fund trading scandal of 2003-04.

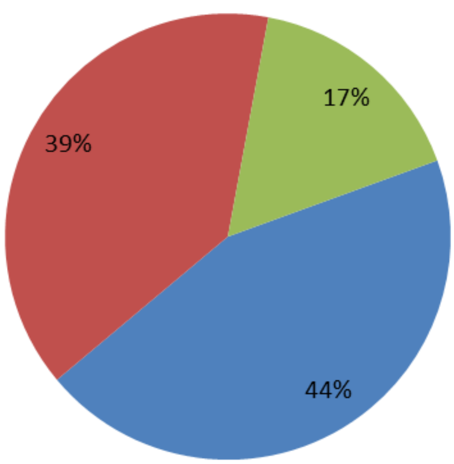


(2001-2010, *including* scandal-related claims)

Defense Costs

Settlements & Judgments

Costs of Correction



(2001-2010, *excluding* scandal-related claims)

Endnotes

[1] Zametkin v. Fidelity Mgmt. & Research Co., No. 1:08-cv-10960 (D. Mass. Nov. 16, 2010); In re Morgan Keegan Secs., Derivative & ERISA Litig., 2010 U.S. Dist. LEXIS 104246 (W.D. Tenn. Sept. 30, 2010); In re Evergreen Ultra Short Opportunities Fund Secs. Litig., 705 F. Supp. 2d 86 (D. Mass. 2010); Gosselin v. First Trust Advisors L.P., 2009 U.S. Dist. LEXIS 117737 (N.D. Ill. Dec. 17, 2009); Northstar Fin. Advisors, Inc. v. Schwab Invs., 609 F. Supp. 2d 938 (N.D. Cal. 2009).

[2] Yu v. State Street Corp., No. 1:08-cv-8235 (S.D.N.Y. Mar. 31, 2011).

[3] Rafton v. Rydex Series Funds, No. 5:10-cv-1171 (N.D. Cal. Jan. 5, 2011).

[4] Stoopler v. Direxion Shares ETF Trust, No. 1:09-cv-8011 (S.D.N.Y. filed Sept. 18, 2009) (motion to dismiss pending); In re ProShares Trust Secs. Litig., No. 1:09-cv-6935 (S.D.N.Y. filed Aug. 5, 2009).

[5] *See generally* ICI Mutual's 2010 risk management study, *Mutual Fund Prospectus Liability*, at pp. 7-8.

[6] La Pietra v. RREEF Am., L.L.C., 2010 U.S. Dist. LEXIS 96968 (S.D.N.Y. Sept. 14, 2010); In re Morgan Keegan Open-End Mutual Fund Litig., 2010 U.S. Dist. LEXIS 104246 (W.D. Tenn. Sept. 30, 2010).

[7] In re Alliance, Franklin Templeton, Bank of America, Pilgrim Baxter, No. 1:04-md-15862 (D. Md. Dec. 9, 2010) (granting motion for summary judgment as to Franklin defendants).

[8] Operating Local 649 Annuity Trust Fund v. Smith Barney Fund Mgmt. LLC, 595 F.3d 86 (2d Cir. 2010). On remand, the trial court permitted some of the rule 10b-5 claims to continue, while dismissing other 10b-5 claims on standing or other grounds. *See* In re Smith Barney Fund Transfer Agent Litig., No. 1:05-cv-7583 (S.D.N.Y. Jan. 25, 2011).

[9] Janus Capital Group v. First Derivative Traders, 566 F.3d 111 (4th Cir. 2009), *cert. granted*, 2010 U.S. LEXIS 5369 (U.S. June 28, 2010) (No. 09-525).

[10] 15 U.S.C. § 80a-35(b) (2007).

[11] Jones v. Harris Assocs. L.P., 130 S. Ct. 1418, 1426 (U.S. 2010). This standard was first articulated by a federal appellate court in Gartenberg v. Merrill Lynch Asset Mgmt., Inc., 694 F.2d 923 (2d Cir. 1982).

[12] *See* Jones v. Harris Assocs. L.P., No. 07-1624 (7th Cir. filed Mar. 20, 2007), *remanded from* Jones v. Harris Assocs. L.P., 130 S. Ct. 1418 (U.S. 2010).

[13] Gallus v. Ameriprise Fin., Inc., No. 11-1091 (8th Cir. filed Jan. 13, 2011).

[14] *See* In re Federated Mut. Funds Excessive Fee Litig., No. 04-cv-00352 (W.D. Penn. Mar. 23, 2011) (court ordering case to be marked closed, but retaining jurisdiction over the completion and implementation of a settlement agreement); Bennett v. Fidelity Mgmt. & Research Co., No. 1:04-cv-11651 (D. Mass. filed July 23, 2004) (motion for summary judgment remains pending).

[15] *See* Curran v. Principal Mgmt. Corp., LLC, 2010 U.S. Dist. LEXIS 83730 (S.D. Iowa June 8, 2010).

[16] *See* In re Am. Mut. Funds Fee Litig., 2009 U.S. Dist. LEXIS 120597 (C.D. Cal. Dec. 28, 2009), *appeal docketed* No. 10-55221 (9th Cir. Feb. 12, 2010); In re Salomon Smith Barney Mut. Fund Fees Litig., 528 F. Supp. 2d 332 (S.D.N.Y. 2007), *appeal docketed*, No. 08-38 (2d Cir. Jan. 2, 2008).

[17] Specifically, the plaintiffs claim that the defendants charged certain retirement plans and, indirectly, plan participants, "unreasonable and excessive fees," and thereby breached their fiduciary duties under ERISA and engaged in prohibited transactions in violation of ERISA. Santomenno v. John Hancock Life Ins. Co., No. 2:10-cv-1655 (D.N.J. filed Mar. 31, 2010). A similar case was filed in early 2011 by the same plaintiffs' lawyers against

another insurance company and certain affiliated investment advisers. That lawsuit also challenges fees under ERISA and seeks to recover advisory fees, but, rather than alleging violation of ICA section 36(b), the lawsuit seeks to recover certain fees based on the allegation that one defendant acted as an unregistered investment adviser in violation of IAA section 203. Santomenno v. Transamerica Life Ins. Co., No. 2:11-cv-00736 (D.N.J. filed Feb. 8, 2011).

[18] Southworth v. Hartford Inv. Fin. Servs. LLC, No. 10-cv-878 (D. Del. filed Oct. 14, 2010) (motion to dismiss pending); Kasilag v. Hartford Inv. Fin. Servs. LLC, No. 11-cv-01083 (D.N.J. filed Feb. 25, 2011).

[19] Halebian v. Berv, 590 F.3d 195 (2d Cir. 2009). The federal appellate court had been awaiting a decision by the highest state court in Massachusetts on a procedural issue, relating to the applicability of the business judgment rule where a derivative complaint is filed before a corporation rejects a shareholder derivative demand. The decision by the Massachusetts court was issued in August 2010. *See* Halebian v. Berv, 2010 Mass. LEXIS 596 (Mass. Aug. 23, 2010). As of the time this *Claims Trends* went to press, the Second Circuit had not yet issued a decision, and the appeal remained pending.

[20] Smith v. Franklin/Templeton Distribs., 2010 U.S. Dist. LEXIS 112934 (N.D. Cal. Oct. 22, 2010), *appeal docketed*, No. 10-17648 (9th Cir. Nov. 19, 2010).

[21] Wiener v. Eaton Vance Distribs., Inc., No. 1:10-cv-10515 (D. Mass. Mar. 30, 2011).

[22] Smith v. OppenheimerFunds Distrib., Inc., Nos. 1:10-cv-7387 & 1:10-cv-7394 (S.D.N.Y. filed Sept. 27, 2010) (originally filed in D. Colo. in Mar. 2010) (motion to dismiss remains pending).

[23] *See*, *e.g.,* Morgan Asset Mgmt., Inc., No. 3-13847 (SEC filed Apr. 7, 2010); Morgan Keegan & Co., Inc., No. 2007011164501 (FINRA filed Apr. 7, 2010).

[24] SEC, *Testimony Concerning Investigation and Prosecuting Fraud after the Fraud Enforcement and Recovery Act*, at pp. 12, 14-15 (Sept. 22, 2010), http://www.sec.gov/news/testimony/2010/ts092210rk.htm (testimony of Robert Khuzami, Director, Division of Enforcement, before the United States Senate Committee on the Judiciary).

[25] The coverage also requires the insured to obtain ICI Mutual's advance consent before incurring any costs for which the insured may seek reimbursement. *See generally* ICI Mutual's 2009 risk management study, *Mutual Fund D&O/E&O Insurance* (at pp. 35-36, discussing insurance for the costs of correcting operations-based errors).

[26] *See*, *e.g.,* Halebian v. Berv, *supra* note 19.

[27] *See* Northstar Fin. Advisors, Inc. v. Schwab Invs., 615 F.3d 1106 (9th Cir. 2010); In re Regions Morgan Keegan Secs., Derivative & ERISA Litig., *supra* note 1.

[28] *See* "D&O/E&O Insurance Coverage for Shareholder Derivative Demand Investigations – Frequently Asked Questions" (Jan. 2011), *available at* http://www.icimutual.com/pdf/SDDI_FAQ.pdf.

[29] *See* Kastel v. Nuveen Invs. Inc., No. 1:09-cv-646 (M.D.N.C. filed Aug. 21, 2009) (motions to dismiss, filed in June and July 2010, remain pending).

[30] *See* Richelson v. John Hancock Advisers, LLC, No. 10-3355A (Mass. Super. Ct. Mar. 3, 2011).

[31] *See* Brown v. Calamos, No. 10-cv-6558 (N.D. Ill. Mar. 14, 2011), *appeal filed*, No. 11-1785 (7th Cir. filed Apr. 5, 2011).

[32] *See* McBrearty v. Vanguard Group, Inc., No. 09-1445, 353 Fed. Appx. 640, 641-42 (2d Cir. 2009).

ICI Mutual | *an uncommon value*

Aligned Interests:
owned by, governed by and operated for mutual funds
and their advisers, directors and officers

Mutual Fund Knowledge and Expertise:
tailored, innovative coverage combined with
expert claims handling

Availability, Stability and Financial Strength in All Markets:
consistent coverage and strong capital

ICI Mutual is the predominant provider of D&O/E&O liability insurance and fidelity bonding for the U.S. mutual fund industry. Its insureds represent more than 65% of the industry's managed assets. As the mutual fund industry's captive insurance company, ICI Mutual is owned and operated by and for its insureds. ICI Mutual's services assist insureds with identifying and managing risk and defending regulatory enforcement proceedings and civil litigation.

ICI Mutual also serves as a primary source of industry information regarding mutual fund insurance coverage, claims, risk management issues, and litigation developments. Publications include an extensive library of risk management studies addressing such topics as corporate action processing, investment management compliance, computer security, defense cost management, identity theft, independent director litigation risk, prospectus liability risk, ERISA liability, and operational risks in managing private accounts, among others, and the *Investment Management Litigation Notebook*, risk manager alerts, and the annual *Claims Trends* newsletter. Additional services include peer group profiles, coverage analyses, and assistance to insureds and their counsel in litigation defense.

ICIMutual
A Risk Retention Group

1401 H Street NW, Suite 1000
Washington, DC 20005

800.643.4246
info@icimutual.com

www.icimutual.com