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MUTUAL FUNDS AND SECURITIES CLASS ACTIONS: A SQUARE PEG IN A ROUND HOLE

The authors describe securities class actions concerning mutual funds as “relatively sparse” and “often divergent.” They discuss the cases focusing on three prominent issues: loss causation, control person liability, and reliance.

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The popularity and growth of mutual funds have made it an over \$16 trillion industry, a fact not lost on the federal securities plaintiffs’ bar.¹ But bringing class actions on behalf of mutual fund investors is not without significant obstacles. The primary federal statute governing mutual funds, the Investment Company Act of 1940 (the “ICA”), provides only a single, express, private right of action. That right of action under Section 36(b) of the ICA limits recovery to the amount of fees charged by a mutual fund’s investment adviser, and the statute provides significant procedural safeguards for defendants.² Mutual funds are also subject to the Securities Act of 1933 (the “Securities Act”) and the Securities Exchange Act of 1934 (the “Exchange Act”), the traditional vehicles of choice for securities class action plaintiffs’ lawyers. But those statutes present

unique issues when mutual funds are involved, and impose additional hurdles for plaintiffs that are more challenging than those plaintiffs face in a traditional securities class action against a corporate issuer of securities.

At the time the Securities Act and Exchange Act were enacted, mutual funds obviously were not in the forefront of the drafters’ minds. In the wake of the Great Depression, Congress was focused on enacting legislation aimed at traditional corporate issuers and protecting shareholders of those types of securities (*e.g.*, shares of common stock). Moreover, almost all of the last 80 years of caselaw interpreting the relevant provisions of the Securities Act and Exchange Act has involved claims brought by shareholders of corporate issuers, not mutual funds. Only more recently have courts begun to address how these statutes apply to funds. The result has been a revelation that the unique legal and structural characteristics of mutual funds, and their very nature as pooled investment vehicles that hold a basket of many underlying investments, makes them fundamentally different from the individual securities

¹ Investment Company Institute, *2017 Investment Company Fact Book: A Review of Trends and Activities in the Investment Company Industry* (57th Ed.) at 9.

² Investment Company Act of 1940, § 36(b), 15 U.S.C.A. § 80a-35(b); *Jones v. Harris Assocs. L.P.*, 559 U.S. 335, 340 (2010).

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