

# New York Pushes Mutual Fund Active Share Disclosure

FINANCIAL SERVICES REGULATORY | SECURITIES & INVESTMENT COMPANIES | LIFE, ANNUITY, AND RETIREMENT SOLUTIONS | JUNE 25, 2018



**Edmund J. Zaharewicz**

New York's Attorney General issued a report on its recent investigation of fees charged by actively managed equity mutual funds and a metric known as "Active Share." Denoted as a "percentage" from 0 to 100 percent, Active Share measures the degree of overlap between a fund's portfolio and its benchmark index. For example, an Active Share of 100 percent means that a fund and its benchmark have no holdings in common, while an Active Share of 0 percent means that the fund and its benchmark have proportionately identical holdings. Active Share is only one measure of how much "active management" is being done by the fund's manager.

The Attorney General analyzed fee and Active Share data for more than 2,000 funds to understand whether funds' fees reflect their ability to outperform their benchmarks. The Attorney General surveyed 14 major mutual fund firms "to determine whether and how firms use the Active Share metric, and whether and how firms disclose the Active Share metric to retail and institutional investors." The report's "key findings" include:

- On average, actively managed funds cost investors 4.5 times more than passively managed funds.
- Active Share varies widely for high fee, actively managed equity funds.
- "[I]nvestors cannot necessarily assume that a high fee means that a fund will have a high level of active management."
- Retail investors often do not have access to Active Share information.

Following the investigation, the surveyed firms that were not already doing so agreed to post Active Share information for each of their actively managed equity funds (400 in all) quarterly on their websites. Moreover, the report calls on all actively managed equity mutual funds, presumably including those dedicated to supporting variable insurance products, to make Active Share information readily accessible to all investors.

Although the report characterizes Active Share as a "valuable piece of information" that will allow investors "to assess whether the fees they are paying are acceptable in light of a particular fund's overlap with its benchmark," retail investors may not readily understand the inferences that can properly be drawn from this metric. For example, the report counsels that, because a fund's Active Share may change over time, investors should evaluate Active Share across multiple time periods, suggesting that a fund's Active Share at any given time may not be particularly relevant. The report goes on to note that commentators disagree about whether Active Share is linked to potential fund performance and that "Active Share may be more or less relevant depending on the type of mutual fund in question."

Unfortunately, the report does not address the potential for investor misunderstanding and, further, offers no guidance regarding what disclosures, if any, should accompany Active Share information that is made available to retail investors. One might also question the wisdom of the Attorney General's efforts to, in effect, "regulate by investigation" in an area that is already subject to comprehensive SEC and FINRA regulation and oversight.

In addition, there is a risk that regulators or private litigants may use a fund's published Active Share information to assert that the fund was less actively managed than it purported to be in other disclosures or that its advisory fee was excessive. In theory, such charges could be made as to any purportedly active fund with a portfolio that significantly overlaps its benchmark. The Attorney General's report will surely hearten, if not embolden, the proponents of such claims.

Thus, notwithstanding the Attorney General's call for readily accessible Active Share information, fund firms should proceed with caution and consider what, if any, explanatory material should accompany any such disclosure. Also, fund boards that do not already do so may wish to weigh the potential relevance of Active Share information when deciding whether to approve fund investment advisory contracts.

©2020 Carlton Fields, P.A. Carlton Fields practices law in California through Carlton Fields, LLP. Carlton Fields publications should not be construed as legal advice on any specific facts or circumstances. The contents are intended for general information and educational purposes only, and should not be relied on as if it were advice about a particular fact situation. The distribution of this publication is not intended to create, and receipt of it does not constitute, an attorney-client relationship with Carlton Fields. This publication may not be quoted or referred to in any other publication or proceeding without the prior written consent of the firm, to be given or withheld at our discretion. To request reprint permission for any of our publications, please use our Contact Us form via the link below. The views set forth herein are the personal views of the author and do not necessarily reflect those of the firm. This site may contain hypertext links to information created and maintained by other entities. Carlton Fields does not control or guarantee the accuracy or completeness of this outside information, nor is the inclusion of a link to be intended as an endorsement of those outside sites.