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SEC Extends Multi-Manager Exemptive Relief to Partially-Owned Subadvisers

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On May 29, 2019, the US Securities and Exchange Commission (SEC) issued an order (New Order) expanding the scope of exemptive relief available to multi-manager funds.[1] The New Order is the first exemptive order issued by the SEC to extend multi-manager relief to all subadvisers, including "Wholly-Owned Subadvisers," "Affiliated Subadvisers," and "Non-Affiliated Subadvisers," which are defined terms in the New Order.[2]

The New Order, which eliminates a costly and time consuming regulatory requirement for funds that employ partially-owned Affiliated Subadvisers, is a logical step in the evolution of multi-manager relief that will provide funds with management flexibility and benefit shareholders.

The New Order was issued to Carillon Series Trust, a registered investment company (Carillon Funds), and their investment adviser, Carillon Tower Advisers, Inc. (Adviser), a subsidiary of Raymond James Financial, Inc. It permits Carillon Funds and the Adviser to enter into new or modified subadvisory agreements with any existing or new subadviser, without the approval of fund shareholders, regardless of the level of the subadviser's affiliation with the Adviser. The previous order obtained by the Carillon Funds and the Adviser (Prior Order) granted substantially similar exemptive relief to the Carillon Funds and the Adviser solely with respect to subadvisers that either are Wholly-Owned by the Adviser or its parent company or Non-Affiliated with the Adviser.[3]

On July 9, 2019, the SEC Staff granted no-action relief to The BNY Mellon Family of Funds, BNY Mellon Funds Trust, and BNY Mellon Investment Adviser, Inc. (No-Action Letter).[4] The No-Action Letter underscores the importance of the New Order by permitting a fund complex that previously has obtained a multi-manager order to rely on that order with respect to any subadviser, regardless of its affiliation with the manager or investment adviser, without seeking an amended order from the SEC. However, the No-Action Letter requires the fund complex to comply with the conditions set forth in the New Order, which are described below. Mutual fund complexes that operate in so-called "multi-manager" or "manager of managers" structures do so pursuant to exemptive orders that grant the same or similar relief as the Prior Order. These complexes likely will rely on the No-Action Letter to extend that relief to Affiliated Subadvisers.

Recent consolidation in the investment management industry has been marked by the acquisition by larger advisory firms of majority or minority ownership interests in smaller firms. The acquisition of a partial ownership interest allows a larger firm to expand its product offerings and increase its profit margin. It also allows a smaller firm to maintain a

level of independence and key personnel to retain a continued ownership interest in the success of the firm. However, partial acquisitions in the past have limited the flexibility of funds that utilize partially-owned Affiliated Subadvisers.

The New Order and No-Action Letter are critically important and welcome developments. In particular, the New Order and No-Action Letter bring the regulatory framework governing mutual funds that operate in a multi-manager structure in line with industry merger and acquisition trends. The No-Action Letter makes the relief granted by the New Order accessible to all funds that operate pursuant to multi-manager exemptive relief. Until now, advisory firms that are partially-owned by a fund's investment adviser or its parent company have been excluded from multi-manager orders. By extending the scope of multi-manager relief to partially-owned subadvisers and the availability of the relief to funds that operate pursuant to a multi-manager exemptive order, the SEC also has furthered the historical purpose of multi-manager orders by promoting the efficient and cost-effective operation of funds in a manner consistent with the best interests of shareholders.

Background

Traditional Investment Advisory Structure

Most mutual funds are externally managed and do not have employees of their own. As a result, mutual funds typically enter into a written contract with an investment adviser to provide or oversee the provision of all administrative, investment advisory, and portfolio management services. If an advisory contract permits the investment adviser to delegate some or all of its duties to one or more subadvisers, either (1) the investment adviser may enter into a separate contract with one or more subadvisers and compensate a subadviser from the fee it receives from the fund (Traditional Pay Arrangement); or (2) the fund may enter into a direct contractual relationship with one or more subadvisers and compensate the subadviser(s) directly (Direct Pay Arrangement). These are terms used by the SEC Staff.

Section 15 of the 1940 Act

Section 15 of the 1940 Act governs the process by which a fund enters into, renews, and materially amends advisory contracts. The 1940 Act does not distinguish between investment advisory and subadvisory contracts. As a result, the Section 15 requirements apply equally to advisory and subadvisory contracts.

Section 15 prohibits any person from serving as an investment adviser to a registered investment company, other than pursuant to a written contract that has been approved by: (1) the vote of a majority of the fund's outstanding voting securities; and (2) a majority of the fund's board of trustees, including a majority of the trustees who are not parties to the contract or "interested persons" of any such party, as defined in Section 2(a)(19) of the 1940 Act (Independent Trustees).[5] Section 15(a) requires that, for an advisory contract to continue in effect for a period more than two years from the date of its execution, its continuance must be specifically approved at least annually by the fund's board of trustees or by vote of a majority of the fund's outstanding voting securities.

The SEC Staff takes the position that a material change to an advisory contract creates a new contract and, therefore, requires shareholder approval under Section 15(a).[6] Further, Section 15(a)(4) requires that an advisory contract provide, in substance, that it will terminate automatically in the event of its "assignment," which is deemed to result from a change in control of a fund's investment adviser or subadviser.[7] When an advisory contract terminates automatically due to an assignment, a fund must enter into a new contract with the investment adviser and obtain board and shareholder approval. Automatic termination of the contract occurs even though there may be no change in the personnel or organization of the investment group responsible for managing a fund's portfolio.

Holding a shareholder meeting to obtain approval of an investment advisory contract is a costly and time-intensive process that typically delays the implementation of an advisory contract by several months. After a fund begins investment operations and has public shareholders, the shareholder approval process is more burdensome and costly.[8] Funds can obtain shareholder approval of an advisory contract only by filing a proxy statement with the SEC, mailing that proxy statement to shareholders and soliciting the votes of a "majority of the outstanding voting securities."[9] This process may delay the hiring of a subadviser and thereby inhibit an investment adviser's ability to manage a subadvised fund efficiently and in the best interests of the fund and its shareholders.

Emergence of Multi-Manager Exemptive Relief

Investment advisers and boards of trustees that delegate portfolio management responsibilities to a subadviser often need to respond promptly if an underperforming subadviser should be replaced or an additional subadviser should be hired. However, while portfolio managers may be hired or replaced without shareholder approval, hiring a subadviser or materially modifying a subadvisory agreement is costly and time-intensive because of the shareholder meeting, proxy statement and shareholder proxy solicitation.

Investment advisers that provide services directly to funds employ one or more portfolio managers to make day-to-day investment decisions. Unless the portfolio manager is a fund officer, the investment adviser may terminate and hire individual portfolio managers without board or shareholder approval and has sole discretion to set the portfolio managers' compensation. Alternatively, a significant number of investment advisers hire subadvisers to make day-to-day investment decisions for all or a portion of a funds' assets. In both cases, primary responsibility for the management of fund assets remains vested in the investment adviser, subject to the oversight of the fund's board of trustees.

The investment responsibilities of a subadviser are similar to that of a portfolio manager in a traditional single adviser structure. In addition, the investment adviser's oversight role with respect to a fund's portfolio managers and subadvisers is substantially the same. The investment adviser supervises the subadvisers' investment decisions in a manner that in some respects mirrors its supervisory role with respect to the investment decisions made by in-house portfolio managers. However, unlike portfolio managers, subadvisors only may be hired or changed in accordance with Section 15.

The SEC and the SEC Staff recognized the increased use of subadvisers and the need for investment advisers to promptly hire or replace those subadvisers when the SEC granted the initial multi-manager exemptive order to the Frank Russell Investment Company (Frank Russell Order) in 1995.[10] The Frank Russell Order permitted an investment adviser to enter into subadvisory contracts with Non-Affiliated Subadvisers without obtaining shareholder approval. The applicants seeking that order pointed out that the investment adviser would supervise the subadvisers and make subadviser changes as needed, but that requiring shareholder approval for each change would prevent the investment adviser "from performing on a timely and effective basis the principal function the shareholders are paying it to perform—the selection, monitoring, and changing of [subadvisers]."[11] The applicants also agreed to comply with a number of conditions to ensure that shareholder interests were adequately protected. Those conditions have been revised and expanded on in subsequent multi-manager exemptive orders, as described below.

The SEC extended the scope of multi-manager relief to Wholly-Owned Subadvisers in 2000 in an order permitting investment advisers to enter into and materially amend subadvisory agreements with Non-Affiliated Subadvisers and Wholly-Owned Subadvisers without shareholder approval (PIMCO Order).[12] In the PIMCO Order, the SEC also granted relief with respect to a new subadvisory

agreement that would replace an agreement with a Non-Affiliated or Wholly-Owned Subadviser that had terminated automatically due to an assignment.

Mutual fund complexes and investment advisers applying for multi-manager relief have pointed out that the extension of multi-manager relief to Wholly-Owned Subadvisers does not present a conflict of interest or risk of self-dealing because the conditions of the exemptive orders granting the relief are designed to protect shareholders. These conditions include: (1) at all times, a majority of the members of a fund's board of trustees will be Independent Trustees; (2) for any fund using an Affiliated Subadviser, the board of trustees must make a separate finding that any change in subadviser is in the best interest of that fund and its shareholders; (3) a new subadviser must be approved by a majority of the trustees who are limited in their ability to have a financial interest in that subadviser; (4) the board of trustees must review the fees and other terms of a proposed subadvisory agreement where a Non-Affiliated Subadviser is replaced by a Wholly-Owned Subadviser; and (5) each subadvisory agreement must remain subject to the annual review by the board of trustees.[13]

Aggregate Fee Disclosure

In connection with a request for exemptive relief from the shareholder approval requirement under Section 15(a), mutual funds and their advisers also have sought exemptive relief from certain requirements with respect to the disclosure of investment advisory and subadvisory fees under Form N-1A, Schedule 14A and Regulation S-X. Specifically, these rules require funds to disclose the fee schedule for each investment adviser and subadviser (1) in registration statements pursuant to Item 19(a)(3) of Form N-1A; (2) in proxy statements pursuant to Items 22(c)(1)(ii), 22(c)(1)(iii), 22(c)(8), and 22(c)(9) of Schedule 14A under the Securities Exchange Act of 1934, as amended (Exchange Act); and (3) in annual and semi-annual reports pursuant to Sections 6-07(2)(a), 6-07(2)(b), and 6-07(2)(c) of Regulation S-X under the Securities Act of 1933, as amended.[14]

The Frank Russell Order required each subadvised fund to disclose in applicable disclosure documents only the aggregate subadvisory fee paid by the fund, rather than the fee paid to each Non-Affiliated Subadviser.[15] In the PIMCO Order, the SEC extended the scope of the disclosure relief to Wholly-Owned, but not partially-owned, subadvisers, allowing a subadvised fund to disclose in its registration statement: (1) the aggregate fees paid to the investment adviser and Wholly-Owned Subadvisers; (2) the aggregate fees paid to Non-Affiliated Subadvisers; and (3) the individual fee paid to each Affiliated Subadviser, other than Wholly-Owned Subadvisers.[16]

Mutual fund complexes and investment advisers applying for multi-manager relief generally have reasoned that public disclosure of the individual fees paid by the investment adviser to each subadviser would not serve any meaningful purpose. From a shareholder point of view, it is the aggregate advisory fee rate paid by the fund on an annual basis that is important. Further, applicants have noted that extending relief to Non-Affiliated and Wholly-Owned Subadvisers would benefit shareholders by improving an investment adviser's ability to negotiate lower subadvisory fee rates. In particular, if subadvisory fee rates are confidential, the subadviser may be more likely to offer a discounted fee rate to a particular fund because that rate would not be disclosed to other clients.[17]

Aggregate Fee Guidance Update

Multi-manager orders have no effect on the Section 15 requirement that the aggregate fee rate payable by a fund for advisory services be subject to shareholder approval. Consistent with this requirement, an increase in the aggregate advisory fee rate payable by a fund by operation of either the primary advisory contract alone (in a Traditional Pay Arrangement) or a combination of the primary advisory contract and one or more subadvisory contracts

(in a Direct Pay Arrangement) also remains subject to shareholder approval. In 2014, the Staff of the SEC's Division of Investment Management issued a guidance update (Guidance Update) to provide interpretive advice to funds regarding the circumstances that would be deemed to constitute an increase in a fund's aggregate advisory fee rate that necessitates shareholder approval.[18]

Recognizing the differences between Traditional Pay Arrangements and Direct Pay Arrangements, the Guidance Update explained that shareholder approval would be required in the event of any increase in (1) the investment advisory fee rate payable under the primary investment advisory contract in a Traditional Pay Arrangement, or (2) the aggregate combined advisory and subadvisory fee rate payable by a fund in a Direct Pay Arrangement.

The Guidance Update also explained that shareholder approval would not be required in a Direct Pay Arrangement where: (1) concurrently with the hiring of an initial subadviser, a fund implements a corresponding reduction in the investment advisory fee rate to avoid an increase in the aggregate advisory rate; (2) a fund with one or more subadvisers hires a new subadviser whose rate is no higher than the rate of (a) the subadviser being replaced or (b) if a subadviser is not being replaced, an existing subadviser that could have covered the assets allocated to the new subadviser; or (3) a fund with one or more subadvisers increases an existing subadviser's rate but decreases the investment adviser's rate such that the aggregate advisory fee does not increase.

The Guidance Update noted that multi-manager orders that contemplate a Direct Pay Arrangement include a condition requiring the fund to seek shareholder approval for any subadvisory contract change that would result in an increase in the aggregate advisory rate (the Aggregate Fee Condition). However, prior to the issuance of the Guidance Update, the Aggregate Fee Condition was not included in multi-manager orders that contemplated a Traditional Pay Arrangement. The Guidance Update requested that all new applications for multi-manager relief include the Aggregate Fee Condition, regardless of whether the multi-manager order contemplated a Direct Pay Arrangement or the Traditional Pay Arrangement. Accordingly, beginning in 2014, all multi-manager orders have included the Aggregate Fee Condition.[19]

Proposed Rule 15a-5

In 2003, the SEC proposed to eliminate the need for a fund to obtain an SEC exemptive order to facilitate multi-manager arrangements.[20] In the proposing release for Rule 15a-5, the SEC explained:

> Many sponsors of [multi-manager] funds have asserted that without relief from the shareholder voting requirement, the costs and delays associated with obtaining a shareholder vote would prevent advisers from hiring and firing subadvisers and from achieving the funds' investment objectives. They also have asserted that the underlying purpose of section 15(a) - to give shareholders a voice in the fund's investment advisory arrangements - would be satisfied without a shareholder vote on the subadvisory contracts because the principal adviser's contract must still be approved by fund shareholders.[21]

As proposed, Rule 15a-5 also would have allowed a subadvised fund to choose not to disclose the individual fees paid to Non-Affiliated Subadvisers, though this disclosure relief would not have extended to Affiliated Subadvisers.[22]

Proposed Rule 15a-5 was never adopted. However, in the years following the rule proposal, the SEC has continued to grant multi-manager exemptive relief and the related disclosure relief to funds with respect to Wholly-Owned and/or Non-Affiliated Subadvisers. Each order has been subject to a number of conditions, including that the multi-manager order will expire in the event that the SEC adopts a rule under the 1940 Act providing substantially similar relief.

The New Order

The Carillon Funds and the Adviser initially filed the Carillon Application in 2013. However, for a number of years, the SEC Staff was reluctant to recommend extending multi-manager exemptive relief to Affiliated Subadvisers (other than Wholly-Owned Subadvisers). Finally, the SEC Staff agreed that funds seeking to hire partially-owned subadvisers should not have to obtain shareholder approval in order to enter into such arrangements.

Shareholder Approval

The New Order permits the Carillon Funds and the Adviser to enter into and materially amend any subadvisory agreement without the shareholder approval required by Section 15(a) of the 1940 Act. The relief from the shareholder approval requirement also extends to the replacement or reinstatement of any subadviser when a subadvisory agreement automatically has terminated due to an "assignment" within the meaning of Section 2(a)(4) of the 1940 Act. The Carillon Funds and the Adviser currently operate pursuant to a Traditional Pay Arrangement, but the Carillon Application notes that the relief would apply to a subadvised fund that operates in a Direct Pay Arrangement.[23]

The Carillon Funds and the Adviser pointed out in the Carillon Application that each subadviser performs much the same function as a portfolio manager to the relevant series of the Carillon Trust (each, a Fund and collectively, the Funds). They argued that shareholders expect and rely on the Adviser to select and monitor subadvisers that will benefit the Fund, in the same way that shareholders rely on the Adviser to select portfolio managers. They also represented that the Adviser performs substantially identical oversight of all subadvisers, regardless of the subadviser's affiliation with the Adviser, and that that the Adviser's oversight of subadvisers is similar in many respects to how the Adviser would oversee its own internal portfolio management team. Additionally, the Carillon Funds and the Adviser stated that the Adviser is accountable to the Carillon Fund's board of trustees (Board), which oversees and approves the Adviser's subadviser selections and considers the reasonableness of each subadviser's compensation.[24]

The Carillon Funds and the Adviser noted in the Carillon Application that any conflict of interest or economic incentive that may arise when the Adviser recommends a subadviser would be mitigated by the conditions set forth in the New Order. They explained that: (1) the Adviser faces those conflicts and incentives in allocating Fund assets between itself and any subadviser, including Affiliated Subadvisers; (2) the Adviser employs the same methodology to evaluate potential conflict of interest, regardless of any affiliation between the Adviser and subadviser; and (3) the interests of Fund shareholders are protected by the conditions set forth in the New Order, which are described below. [25]

In addition, the Carillon Funds and the Adviser pointed out that Fund shareholders would benefit from greater efficiencies and reduced costs by avoiding the timely and costly process of holding a shareholder meeting and soliciting shareholder votes. The Carillon Application also noted that shareholders would continue to be notified of a subadviser change or a material amendment to a subadvisory agreement.[26]

Aggregate Fee Disclosure

The New Order permits each Fund to disclose in its registration statement the aggregate fees paid to (1) the Adviser and any Wholly-Owned Subadviser; and (2) any Affiliated and Non-Affiliated Subadvisers. Therefore, where the subadviser is Wholly-Owned, the Fund would be required to disclose only the aggregate fee paid to the Adviser and that subadviser. Where a Fund has several subadvisers that are partially-owned or Non-Affiliated, the Fund would be required to disclose the fee paid to the Adviser and the aggregate fee paid to any partially-owned or Non-Affiliated Subadvisers. However, where a Fund has a single partially-owned or Non-Affiliated Subadviser, the Fund would continue to be subject

to the requirement to disclose separately the fees paid to the Adviser and subadviser. Hence, the New Order does not provide disclosure relief for a single subadvised Fund with a subadviser that is not Wholly-Owned.

The Carillon Application explained that disclosure of a subadvised Fund's overall advisory fee, rather than each individual subadvisory fee, would sufficiently allow a shareholder to understand a Fund's expenses and compare those expenses to other mutual funds. Further, the Carillon Application stated that the relief would benefit shareholders through the possibility of lower subadviser fees. The Carillon Application reasoned that, if the Adviser is not required to publicly disclose individual subadviser fees, the Adviser may be in a better position to negotiate rates that are below that subadviser's "posted" amounts.[27]

Comparison of Conditions of the Prior Order to Conditions of the New Order

Exhibit 1 compares the conditions of the Prior Order, which are substantially similar to the conditions of recent multi-manager orders that have been issued to other mutual fund complexes, to the conditions of the New Order.

Exhibit 1

Prior Order	***New Order***
The operation of the subadvised fund that is relying on the exemptive relief has been or will be approved by a majority of that fund's outstanding voting securities, as defined in the 1940 Act, or by the fund's initial shareholder before the subadvised fund's shares are offered to the public.	*Substantially Similar.*
The prospectus describes the fund's multi-manager structure, the investment adviser's responsibility to oversee the subadvisers and the existence, substance and effect of the relief granted by the SEC exemptive order.	*Same.*
The investment adviser provides general management services to each subadvised fund, including overall supervisory responsibility for the management and investment of each subadvised fund's assets, and subject to review and approval by a subadvised fund's board of trustees, the investment adviser will: (1) set the subadvised fund's investment strategies; (2) evaluate, select and recommend subadvisers; (3) allocate, and reallocate the subadvised fund's assets among subadvisers; (4) monitor and evaluate the subadvisers' performance; and (5) implement procedures reasonably designed to ensure that subadvisers comply with the subadvised fund's investment objectives, policies and restrictions.	*Substantially Similar.*

Exhibit 1	
Prior Order	***New Order***
A subadvised fund must not make any subadviser changes or material amendments to existing subadvisory agreements with subadvisers that are not covered by the exemptive relief, unless approved by shareholders pursuant to Section 15.	***Eliminated.***
A subadvised fund must inform shareholders of the hiring of a new subadviser covered by the exemptive relief within 90 days through an information statement.[a]	*Substantially Similar.*
At all times, at least a majority of a subadvised fund's board of trustees will be Independent Trustees, and the selection and nomination of new or additional Independent Trustees will be within the discretion of the then-existing Independent Trustees.	*Substantially Similar.*
Independent legal counsel must be retained to represent the Independent Trustees.	*Substantially Similar.*
The investment adviser must provide, no less than quarterly, the board of trustees with information about the profitability of the investment adviser on a per subadvised fund basis.	***Eliminated.***
Whenever a subadviser is hired or terminated, the investment adviser must provide the board of trustees with information showing the expected impact on the profitability of the investment adviser.	*Substantially Similar.*
Whenever a subadviser change is proposed for a subadviser covered by the exemptive relief, the board of trustees, including a majority of the Independent Trustees, must make a separate finding that (a) the change is in the best interests of the subadvised fund and its shareholders, and (b) the change does not involve a conflict of interest from which the investment adviser or applicable subadviser derives an inappropriate advantage.	***Expanded, as set forth below:*** The board of trustees must evaluate any material conflicts that may be present in a subadvisory arrangement. Specifically, whenever a subadviser change (Subadviser Change) is proposed for a subadvised fund or the board of trustees considers an existing subadvisory agreement as part of its annual review process (Subadviser Review): (a) the investment adviser will provide the board of trustees, to the extent not already being provided pursuant to Section 15(c) of the 1940 Act, with all relevant information concerning:

Exhibit 1	
Prior Order	***New Order***
	(i) any material interest in the proposed new subadviser, in the case of a Subadviser Change, or the subadviser in the case of a Subadviser Review, held directly or indirectly by the investment adviser or a parent or sister company of the investment adviser, and any material impact the proposed subadvisory agreement may have on that interest; (ii) any arrangement or understanding in which the investment adviser or any parent or sister company of the investment adviser is a participant that (A) may have had a material effect on the proposed Subadviser Change or Subadviser Review, or (B) may be materially affected by the proposed Subadviser Change or Subadviser Review; (iii) any material interest in a subadviser held directly or indirectly by an officer or trustee of the subadvised fund, or an officer or board member of the investment adviser (other than through a pooled investment vehicle not controlled by such person); and (iv) any other information that may be relevant to the board of trustees in evaluating any potential material conflicts of interest in the proposed Subadviser Change or Subadviser Review. (b) the board of trustees, including a majority of the Independent Trustees, will make a separate finding, reflected in the board of trustees meeting minutes, that the Subadviser Change or continuation after Subadviser Review is in the best interests of the subadvised fund and its shareholders and, based on the information provided to the board of trustees, does not involve a conflict of interest from which the investment adviser, a subadviser, any officer or trustee of the subadvised fund, or any officer or board member of the investment adviser derives an inappropriate advantage.

Exhibit 1

Prior Order	*New Order*
No trustee or officer of a subadvised fund, or director or officer of the investment adviser, may own directly or indirectly (other than through a pooled investment vehicle that is not controlled by such person), any interest in a subadviser, except for (a) ownership of interests in the investment adviser or any entity, other than a Wholly-Owned Subadviser, that controls, is controlled by, or is under common control with the investment adviser, or (b) ownership of less than one percent of the outstanding securities of any class of equity or debt of a publicly traded company that is either a subadviser or an entity that controls, is controlled by, or is under common control with a subadviser.	***Eliminated. However, any trustee that has an ownership interest in a subadviser would not be deemed an Independent Trustee. Section 10 of the 1940 Act requires at least 40 percent of the members of a registered investment company's board of trustees to be Independent Trustees. However, one of the conditions of the New Order is that subadvised funds must, at all times, have a board of trustees where a majority of such trustees are Independent Trustees. Additionally, as a practical matter, in order for a fund to rely on certain exemptive rules[b] adopted by the SEC, the fund must have a board of trustees where a majority of such trustees are Independent Trustees.***
Each subadvised fund must disclose the aggregate fee disclosures in its registration statement.	*Substantially Similar.*
The requested exemptive order will expire in the event the SEC adopts a rule providing substantially similar relief.	*Substantially Similar.*
Any new or amended advisory agreement that directly or indirectly results in an increase in the aggregate advisory fee rate payable by the applicable subadvised fund must be submitted to the subadvised fund's shareholders for approval.	*Substantially Similar.*

[a] In 2018, the Staff of the SEC's Division of Investment Management issued guidance regarding information statements filed in connection with multi-manager exemptive relief. The Staff provided:

> Rule 14c-5 under the Exchange Act requires funds to file a preliminary information statement unless the matter is specifically excluded by the rule. While information statements relating to the approval of advisory contracts are not excluded by the rule, the staff will not object if a fund does not file information statements required by multi-manager exemptive relief with the Commission on a preliminary basis. Funds, of course, are required to file the definitive information statement on the EDGAR system consistent with their exemptive order.

SEC Accounting and Disclosure Information, ADI 2018-03 - Filing information statements in connection with multi-manager exemptive relief, available at *https://www.sec.gov/investment/adi-2018-03-filing-information-statements-connection-multi-manager-exemptive*.

[b] *See, e.g.*, Rule 12b-1 under the 1940 Act (permitting use of fund assets to pay distribution expenses); Rule 17a-7 under the 1940 Act (permitting securities transactions between a fund and certain affiliated persons); Rule 17d-1(d)(7) under the 1940 Act (permitting funds to purchase joint liability insurance policies with affiliates); Rule 17g-1(j) under the 1940 Act (permitting joint fidelity bonds); and Rule 18f-3 (permitting funds to issue multiple classes of shares).

The Conditions: Notable Differences

As noted in Exhibit 1, the conditions for reliance on the New Order are similar to the conditions in the Prior Order, with the few notable differences described below:

- Because the New Order extends to any subadviser, shareholder approval for a subadviser change with respect to a partially-owned subadviser is not required;
- The Adviser is no longer required to provide quarterly profitability information of the Adviser on a per subadvised Fund basis. However, the Board must continue to review profitability information at the time of any proposed subadviser change and as part of its annual review of each subadvisory agreement pursuant to Section 15(c) of the 1940 Act;
- Trustee and officer ownership of an interest in a subadviser is no longer prohibited. As a practical matter, this change would apply only to trustees who are interested persons of a Fund or the Adviser with the meaning of Section 2(a)(19) of the 1940 Act. The independence of an Independent Trustee would be compromised if that trustee held or obtained an ownership interest in a subadviser; and
- The findings that must be made by the Board are expanded to require that the Board evaluate potential material conflicts of interest when a subadviser change is proposed for a subadvised Fund or when the Board considers an existing subadvisory agreement as part of its annual review process. Specifically, the Adviser is required to provide the Board with certain information related to material conflicts of interest each year during the annual review process, including: (1) any material interest the Adviser has in the subadviser and any material impact the subadvisory agreement may have on that interest; (2) any arrangement or understanding in which the Adviser or an affiliate of the Adviser is a participant that may materially affect, or be materially affected by, the subadvisory agreement; (3) any material interest in the subadviser held directly or indirectly by an officer or trustee of the subadvised Fund, or an officer or board member of the Adviser; and (4) any other information that may be relevant to the Board in evaluating potential material conflicts of interest with respect to the subadvisory agreement.

The No-Action Letter

The No-Action Letter permits a fund complex that previously has obtained a multi-manager order to rely on that order with respect to Affiliated Subadvisers, whether wholly-owned or partially-owned by the manager or investment adviser, without seeking an amended order from the SEC. A fund that elects to rely on the No-Action Letter must comply with the conditions of the New Order, including that the fund obtain shareholder approval to operate in a multi-manager structure with respect to the types of subadvisers not previously approved by shareholders. The No-Action Letter notes, however, that a fund cannot rely on the No-Action Letter to implement aggregate fee disclosure relief if the fund's existing multi-manager order did not provide for that relief. In that circumstance, a fund wishing to implement aggregate fee disclosure relief would be required to apply to the SEC for a new order. A mutual fund complex that does not currently operate pursuant to a multi-manager order also would have to apply to the SEC to obtain the type of relief provided by the New Order.

The No-Action Letter permits a fund operating under its exemptive relief to choose to comply with the conditions of the New Order, rather than the conditions in the fund's existing multi-manager order, without obtaining shareholder approval. In that circumstance, the fund would be required to comply with the conditions of the New Order with respect to all existing and future subadvisers. This may be a welcome option for multi-managed funds until they receive shareholder approval to rely on

their existing multi-manager orders with respect to Affiliated Subadvisers. As such, it will be incumbent upon funds and their advisers to determine whether the conditions of the New Order are sufficiently advantageous to make this change.

Takeaways

The extension of multi-manager relief to partially-owned subadvisers is a logical step that will expand the scope of advisory firms that can be hired in a multi-manager structure without shareholder approval. The New Order is particularly timely in light of the recent spate of mergers and acquisitions in the investment management industry. As such, the relief provided in the New Order, which the No-Action Letter has made accessible to other eligible mutual fund complexes, eliminates one regulatory hurdle that managers consider in connection with a partial acquisition of another firm that will serve as a subadviser to a registered investment company. The New Order and the No-Action Letter thereby level the playing field between funds with subadvisers and funds that use portfolio managers who are employees of other advisory affiliates in the fund complex.

As the New Order is the first of its kind, it was considered and approved directly by the SEC Commissioners. The Commissioners allow the SEC Staff to issue future orders that mirror the New Order by delegated authority, and it is our understanding that they intend to do so. Nevertheless, we expect the number of applications to be diminished as other mutual fund complexes operating under multi-manager exemptive orders will likely rely on the No-Action Letter to benefit from the relief provided in the New Order.

The New Order and the No-Action Letter reflect the willingness of the current SEC Commissioners and Staff to regulate mutual funds in a manner designed to more effectively promote their efficient operation while providing the requisite investor protections. These developments demonstrate the ongoing consideration by the SEC and its Staff of practical changes to further the interests of shareholders who invest in multi-manager funds. Indeed, the mutual fund industry would benefit from a formal rulemaking to codify these important advancements.

Mr. Alexander and **Ms. Ingber** are partners, and **Mr. Levine** and **Mr. Mason** are associates, at K&L Gates LLP in Washington, DC.

NOTES

1 *Carillon Series Trust, et al.*, Investment Company Act Release Nos. 33464 (May 2, 2019) (notice) and 33494 (May 29, 2019) (order).

2 The New Order defines a "Wholly-Owned Subadviser" as any investment subadviser that is (1) an indirect or direct "wholly-owned subsidiary" of a fund's investment adviser (Section 2(a)(43) of the Investment Company Act of 1940, as amended (1940 Act), defines a "wholly-owned subsidiary" of a person to mean "a company 95 per centum or more of the outstanding voting securities of which are owned by such person, or by a company which… is a wholly-owned subsidiary of such person); (2) a "sister company" of the fund's investment adviser that is an indirect or direct "wholly-owned subsidiary" of the same company that indirectly or directly wholly owns the investment adviser (the investment adviser's parent company); or (3) a parent company of the investment adviser.

The New Order defines an "Affiliated Subadviser" as any investment subadviser that is not a Wholly-Owned Subadviser, but is an "affiliated person" (as defined in Section 2(a)(3) of the 1940 Act) of a fund or its investment adviser for reasons other than serving as investment subadviser to one or more funds.

The New Order defines a "Non-Affiliated Subadviser" as any investment subadviser that is not an "affiliated person" (as defined in in Section 2(a)(3) of the 1940 Act) of a fund or its investment adviser, except to the extent that an affiliation arises solely because the subadviser serves as a subadviser to one or more funds.

Section 2(a)(3) of the 1940 Act defines "affiliated person" as follows:

> "Affiliated person" of another person means (A) any person directly or indirectly owning, controlling, or holding with power to vote, 5 per centum or more of the outstanding voting securities of such other person; (B) any person 5 per centum or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by such other person; (C) any person directly or indirectly controlling, controlled by, or under common control with, such other person; (D) any officer, director, partner, copartner, or employee of such other person; (E) if such other person is an investment company, any investment adviser thereof or any member of an advisory board thereof; and (F) if such other person is an unincorporated investment company not having a board of directors, the depositor thereof.

[3] *Eagle Capital Appreciation Fund, et al.*, Investment Company Act Release Nos. 32802A (Sept. 18, 2017) (notice) and 32861 (Oct. 16, 2017) (order).

[4] *The BNY Mellon Family of Funds, et al.*, SEC No-Action Letter (July 9, 2019), available at *https://www.sec.gov/investment/bny-mellon-family-funds-070919-15a*.

[5] Pursuant to Section 2(a)(19) of the 1940 Act, "interested person" of an investment company means:

(i) any affiliated person of such company,

(ii) any member of the immediate family of any natural person who is an affiliated person of such company,

(iii) any interested person of any investment adviser of or principal underwriter for such company,

(iv) any person or partner or employee of any person who at any time since the beginning of the last two completed fiscal years of such company has acted as legal counsel for such company,

(v) any person or any affiliated person of a person (other than a registered investment company) that, at any time during the 6-month period preceding the date of the determination of whether that person or affiliated person is an interested person, has executed any portfolio transactions for, engaged in any principal transactions with, or distributed shares for—

(I) the investment company;

(II) any other investment company having the same investment adviser as such investment company or holding itself out to investors as a related company for purposes of investment or investor services; or

(III) any account over which the investment company's investment adviser has brokerage placement discretion,

(vi) any person or any affiliated person of a person (other than a registered investment company) that, at any time during the 6-month period preceding the date of the determination of whether that person or affiliated person is an interested person, has loaned money or other property to—

(I) the investment company;

(II) any other investment company having the same investment adviser as such investment company or holding itself out to investors as a related company for purposes of investment or investor services; or

(III) any account for which the investment company's investment adviser has borrowing authority, and

(vii) any natural person whom the Commission by order shall have determined to be an interested person by reason of having had, at any time since the beginning of the last two completed fiscal years of such company, a material business or professional relationship with such company or with the principal executive officer of such company or with any other investment company having the same investment adviser

or principal underwriter or with the principal executive officer of such other investment company:

Provided, That no person shall be deemed to be an interested person of an investment company solely by reason of (aa) his being a member of its board of directors or advisory board or an owner of its securities, or (bb) his membership in the immediate family of any person specified in clause (aa) of this proviso.

6 *See Franklin Templeton Group of Funds* (pub. avail. July 23, 1997), *https://www.sec.gov/divisions/investment/noaction/1997/franklintempletongroup072397.pdf*; *American Odyssey Funds, Inc.* (pub. avail. Oct. 7, 1996), *https://www.sec.gov/divisions/investment/noaction/1996/americanodyseeyfunds100796.pdf*.

7 Section 2(a)(4) of the 1940 Act defines "assignment" to include "any direct or indirect transfer or hypothecation of a contract or chose in action by the assignor, or of a controlling block of the assignor's outstanding voting securities by a security holder of the assignor. . . ." Although the term "controlling block" of voting securities is not defined under the 1940 Act, Section 2(a)(9) of the 1940 Act defines "control" as "the power to exercise a controlling influence over the management or policies of a company, unless such power is solely the result of an official position with such company." In addition, Section 2(a)(9) of the 1940 Act provides a rebuttable presumption of control when any person beneficially owns, either directly or indirectly, more than 25 percent of the voting securities of a company. A person who does not own more than 25 percent of the voting securities of a company is presumed not to control the company. Accordingly, practitioners generally have treated a transfer of more than 25% of the voting securities of an investment adviser as a change of control that results in the assignment of an advisory contract. However, Rule 2a-6 under the 1940 Act, among other things, provides that a transaction which does not result in a change of actual control or management of an investment adviser should not be deemed an assignment.

8 *See* Investment Company Institute letter to the U.S. Securities and Exchange Commission, SEC Roundtable on the Proxy Process (File No. 4-725) (June 11, 2019), available at *https://www.ici.org/pdf/19_ltr_fundproxy.pdf* (describing the proxy process as "costly and cumbersome for funds and their shareholders," and providing recommendations for improving that process).

9 Under Section 2(a)(42) of the 1940 Act, "[t]he vote of a majority of the outstanding voting securities of a company means the vote, at the annual or a special meeting of the security holders of such company duly called, (A) of 67 per centum or more of the voting securities present at such meeting, if the holders of more than 50 per centum of the outstanding voting securities of such company are present or represented by proxy; or (B) of more than 50 per centum of the outstanding voting securities of such company, whichever is the less."

10 *Frank Russell Investment Company, et al.*, Investment Company Act Release Nos. 21108 (June 2, 1995) (notice) and 21169 (June 28, 1995) (order).

11 Frank Russell Order, *supra* n.10.

12 *See PIMCO Funds: Multi-Manager Series, et al.*, Investment Company Act Release Nos. 24558 (July 17, 2000) (notice) and 24597 (August 14, 2000) (order).

13 *See, e.g.*, *Cash Account Trust, et al.*, Investment Company Act Release Nos. 30151 (July 25, 2012) (notice) and 30172 (August 20, 2012) (order) (Cash Account Order).

14 Regulation S-X sets forth the requirements for financial statements that must be included as part of a registered investment company's registration statement and shareholder reports filed with the SEC. Sections 6-07(2)(a), (b) and (c) of Regulation S-X require a registered investment company to include information about the investment advisory fees in its statement of operations.

15 Frank Russell Order, *supra* n.10.

[16] PIMCO Order, *supra* note 12. Notably, however, the aggregate fee disclosure relief granted by the SEC to multi-managed funds has no effect on the advisory fee disclosure required for a single-subadvised fund.

[17] *See, e.g.*, Cash Account Order, *supra* n.13.

[18] SEC IM Guidance Update, No. 2014-03 (February 2014), available at *https://www.sec.gov/divisions/investment/guidance/im-guidance-2014-03.pdf*.

[19] *See, e.g.*, Application of Carillon Series Trust and Carillon Tower Advisers, Inc., "Fifth Amendment to the Application for an Order of Exemption Pursuant to Section 6(c) of the Investment Company Act of 1940, as Amended (the 1940 Act), from: (1) Certain Provisions of Section 15(a) of the 1940 Act, and (2) Certain Disclosure Requirements under Various Rules and Forms", File No. 812-14194 (Apr. 25, 2019) (Carillon Application). The condition provides that "[a]ny new Subadvisory Agreement or any amendment to an existing Investment Advisory Agreement or Subadvisory Agreement that directly or indirectly results in an increase in the aggregate advisory fee rate payable by the Subadvised Fund will be submitted to the Subadvised Fund's shareholders for approval."

[20] *See Proposed Rule 15a-5*, Investment Company Act Release No. 26230 (Oct. 23, 2003).

[21] *Id.*

[22] *Id.*

[23] *See* Carillon Application.

[24] *Id.*

[25] *Id.*

[26] *Id.*

[27] *Id.*