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Trusted Insight for Independent Oversight

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MFDF Report

Practical Guidance for Fund Directors on Oversight of Subadvisers

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Executive Summary

As the asset management industry expands and grows in complexity, registered fund complexes may strategically outsource certain business functions, including some or all of their investment advisory services, to one or more subadvisers. Registered fund boards and their independent directors play a significant, statutorily defined role in overseeing a fund's subadviser(s) that is of equal importance to their oversight of the fund's investment adviser. This white paper[1] discusses how fund boards and directors[2] can more effectively oversee subadvisers from the selection stage through ongoing monitoring and termination.

The Investment Company Act of 1940, as amended (the "1940 Act"), establishes the board's obligations in overseeing a fund's investment adviser(s), including the primary investment adviser (the "Primary Adviser") and any subadviser. Since the MFDF published its Practical Guidance for Board Oversight of Subadvisers in 2009, the U.S. Securities and Exchange Commission ("SEC") has adopted several landmark rules and issued guidance with direct implications for board oversight of subadvised funds. The Liquidity Rule, Derivatives Rule, and Valuation Rules[3] are among many that enumerate specific requirements and increased reporting to boards of subadvised funds.

Effective board oversight of fund advisers is critical as firms maneuver in an increasingly cost-conscious, risky and competitive business environment. Fund complexes face mounting cost pressures while trying to meet investor demand for complex new products in an environment of constantly evolving cybersecurity risk that has been heightened by the emergence of technologies such as artificial intelligence. Effective board oversight of subadvised funds today demands communication and collaboration among the board, the Primary Adviser, the subadviser and the fund's chief compliance officer ("CCO"). The board's job as always is to be an informed, inquisitive and objective observer acting in the best interest of the fund and its shareholders.

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Introduction

In this update to our 2009 white paper, MFDF provides practical guidance on the board's role relating to subadvisers to registered investment companies. The paper will consider the board's oversight of subadvisers at the selection and hiring stage, the legal requirements regarding the sub-advisory contract, the role of compliance, and the board's ongoing oversight of the adviser with respect to regulations, complex products, trading, risk and other matters. The aim is to provide boards with an overview of salient issues they will encounter in their oversight of subadvised funds and to inform their decision-making and communications with fund management.

Why Use a Subadviser?

A Primary Adviser may hire a subadviser to obtain portfolio management expertise in a particular asset class or strategy, to fill gaps in staff resources, to meet demand for new products, to diversify its investments, or to gain access to the subadviser's distribution channels. Once hired, the subadviser generally will manage all or a portion of the fund's assets and carry out the fund's investment program while the Primary Adviser will oversee and monitor the subadviser's performance, its adherence to the sub-advisory contract and compliance with the securities laws.

Different Sub-advisory Arrangements

In the most common sub-advisory arrangement, the Primary Adviser employs a single subadviser to manage all or a portion, or sleeve, of the fund's portfolio. A Primary Adviser also may hire more than one subadviser with different areas of expertise to manage discrete sleeves of a fund's portfolio.

The decision to hire a subadviser is made by the fund's investment adviser. However, the fund's board of directors must determine that the selection of a subadviser is in the best interest of the fund's shareholders. The board may not be involved early in the selection of the subadviser, but the board will need to approve the subadvisory contract as required under Section 15(c) of the 1940 Act. Accordingly, directors may want to seek insights into the Primary Adviser's selection process, the due diligence undertaken, and the criteria considered in choosing a subadviser over other candidates. In many cases, the board must also determine to recommend that fund shareholders vote to approve the sub-advisory contract, with the factors considered by the board disclosed in the proxy statement.

What Are the Regulatory Considerations?

Exemptive Relief

Some fund sponsors or Primary Advisers adopt a manager-of-managers structure, outsourcing investment advisory functions to several subadvisers while the Primary Adviser provides administrative, operational and other key services to the fund. In a manager-of-managers structure, the Primary Adviser, with approval from the board, is able select and terminate subadvisers for a fund – including affiliated and unaffiliated subadvisers – and to materially change the terms of the fund's sub-advisory contract, without obtaining the shareholder approval that would otherwise be required under Section 15(a) of the 1940 Act. To operate a manager-of-managers structure, a fund complex must seek and obtain approval from the board and shareholders as well as exemptive relief from the SEC. The fund complex must also follow the conditions of the exemptive order once obtained, which typically include, among other things, disclosure, notice and director independence requirements. Each subadviser in a manager-of-managers structure functions similarly to a fund portfolio manager, managing the portion of the fund's day-to-day investment activities delegated to them.

Exemptive orders typically require the Primary Adviser to provide general management services to each fund relying on the order, including overall supervisory responsibility for the general management and investment of fund assets, and enumerate specific expectations. For example, the Primary Adviser, subject to review and approval by the fund board, will: (a) set each fund's overall investment strategies; (b) evaluate, select, and recommend subadvisers to manage all or a portion of a fund's assets; (c) implement procedures reasonably designed to ensure that subadvisers comply with a fund's investment objective, policies, and restrictions; (d) when appropriate, allocate and reallocate a fund's assets among multiple subadvisers; and (e) monitor and evaluate the performance of subadvisers.

More subadvisers, more complexity

The combination of multiple subadvisers adds complexity to fund oversight for boards. Directors may want to know whether the Primary Adviser has established standards, protocols and procedures across multiple subadvisers. Boards also may want to work with the CCO, counsel and others to ensure coordination in reporting, standardized requests for information if necessary, and close scrutiny of regulatory areas such as valuation, fund liquidity classifications and derivatives reporting. Boards also may need to pay close attention to how fees are allocated among the subadvisers; reporting on pre- and post-trade testing for portfolio compliance; cash management and allocation of cash flows to subadvisers; and monitoring how subadvisers are continuously meeting IRS and SEC investment company requirements.

Affiliated vs. Unaffiliated Subadvisers

A Primary Adviser may select a subadviser that is deemed an affiliated person of the Primary Adviser according to the 1940 Act.[4] The board's relationship with an affiliated subadviser under the control of, or under common control with, the Primary Adviser may have relative advantages because of the regular access the board has to the chief investment officer, portfolio managers and fund performance data. However, boards may want to consider the potential conflicts of interest inherent in affiliated sub-advisory relationships.

Potential Conflicts

With affiliated sub-advisory relationships, the board can seek information about any payments between the Primary Adviser and its affiliates to gain a complete understanding of the relationship. These relationships are especially important as directors consider the profitability of the advisory contract to the Primary Adviser or subadviser in connection with the 15(c) contract approval process. Also, in considering the renewal of sub-advisory contracts as part of the annual 15(c) process, boards may evaluate whether information on expenses and profitability should be assessed separately for the adviser and subadviser, or presented on a consolidated basis, or both. The board may wish to be especially attentive to any potential fall-out benefits of the arrangement to the Primary Adviser. In complexes that use both affiliated and unaffiliated subadvisers, the board may wish to establish and communicate to the Primary Adviser any differences in the standards that will be used to evaluate affiliated and unaffiliated subadvisers.

Sections 10 and 17 of the 1940 Act prohibit certain transactions between funds and their affiliated persons, which include the fund's subadviser. The restrictions are designed to prevent affiliated persons from managing the fund for their own benefit rather than for the benefit of the fund's shareholders. The SEC has adopted a series of rules[5] that exempt certain entities, including subadvisers and their affiliates, from these restrictions and, among other things, permit funds to enter into transactions with subadviser affiliates[6] when certain conditions are met.[7] **Boards can seek assurances from the fund CCO that the appropriate fund-level policies and procedures for affiliated transactions have been established and that all subadvisers have reasonable controls in place to adhere to such policies and procedures.** Fund CCOs should receive periodic affiliated transaction compliance reports and certifications from fund subadvisers and report to the board quarterly regarding any such transactions.

Questions for Boards to Consider:

- How will the Primary Adviser identify, disclose, manage and mitigate potential conflicts of interest?
- How is the Primary Adviser assessing subadviser performance track records and/or comparing performance track records for various subadviser candidates?
- How will the Primary Adviser monitor ongoing compliance with the conditions of any exemptive orders and how will material exceptions be escalated to the board?

Maintaining Board Independence

Directors need to exercise care when considering a new subadviser candidate, and advance notice of potential candidates from the Primary Adviser can serve as notice for directors to sell pertinent holdings. Ownership of a security issued by a subadviser or a controlling affiliate should be promptly reported to counsel, management or the fund CCO. Directors should also report whether any members of their immediate families are an officer, director, employee, partner, or 5% shareholder of a subadviser or a candidate for subadviser.[8] Boards of manager-of-managers funds need to exercise care that independent directors do not own securities issued by subadvisers or their controlling affiliates. Inadvertent ownership of these securities can undermine a director's independence and can create legal problems, particularly for items that require separate approval by independent directors under the 1940 Act and its rules. Boards of complexes that use a large number of publicly held subadvisers can develop a procedure for asking directors to periodically check their holdings and confirm to a designated director or counsel that they do not hold securities of subadvisers. Many directors in manager-of-manager fund complexes have found that it is prudent to avoid holding securities of major financial institutions with asset management capabilities. Such policies, however, would not prevent directors from investing in actively managed mutual funds that concentrate in financial institutions. Directors may wish to seek clarification from counsel on investing in passively managed index funds.

How is the Initial Due Diligence Conducted?

When selecting a subadviser, the Primary Adviser will conduct extensive due diligence of subadviser candidates. This usually involves investment-related reviews to determine whether the candidates meet the fund's investment requirements and the criteria established by the Primary Adviser—which are often expressed as "People, Performance, Process, and Philosophy." Some fund complexes have developed a "scorecard" to help evaluate candidates and to provide quantitative measures to the board. However, much of the decision-making is based on subjective criteria about the firm, the portfolio manager, and the prospects for good performance. Candidates (or at least the finalist) also are subject to reviews that focus on compliance, risk, and operations. These reviews usually are carried out by the compliance team for the Primary Adviser or the fund's CCO and may include resources from third-party risk or other functions at the Primary Adviser (See the accompanying box for a summary of the topics covered.) Among other relevant qualitive questions, Boards may wish to ask management about the subadviser's personnel skills and training; whether the subadviser's culture and values are complementary to that of the Primary Adviser; and whether the Primary Adviser is confident that the subadviser would be responsive to its inquiries.

Due Diligence List

Management typically may review and consider the following in its due diligence of subadviser candidates:

- The subadviser's Form ADV responses
- Financial condition and insurance coverage
- Form of organization, ownership, principals' background
- Litigation or threats of litigation, disciplinary history
- Executive leadership, resources, staff quality and compensation, legal and compliance support
- Compliance policies and procedures, how past violations have been remedied
- Regulatory exam and enforcement history
- History managing registered funds
- Results of internal audits and internal controls testing
- Portfolio management processes and strategy performance
- Risk management, cybersecurity and data protection, business continuity, incident response/ disaster recovery, deployment of new technology and artificial intelligence

Primary Adviser and Subadviser Duties

Generally, a subadviser will manage the portion of the fund's assets delegated to it while the Primary Adviser oversees and monitors the subadviser's performance, adherence to the sub-advisory contract, compliance with the securities and relevant tax laws, and eligibility to operate as a subadviser. The following is a non-exhaustive, illustrative list of subadviser and Primary Adviser duties in a typical fund subadvisory relationship. The actual allocation of responsibilities between a fund's Primary Adviser and any subadviser(s) will vary based on factors such as fund structure, the existence of exemptive relief, and contractual arrangements.

Primary Adviser and Subadviser Duties	
Primary Adviser Duties	**Subadviser Duties**
Assessing subadviser candidates; selecting the subadviser; conducting initial and ongoing due diligence	Managing fund assets, including buying and selling securities in accordance with the fund's investment objectives, policies, investment restrictions
Setting fund investment strategies, consulting with fund board on subadviser selection, ongoing board reporting	Obtaining and evaluating investment research, seeking best execution as described in sub-advisory contract
Allocating and reallocating fund assets among multiple subadvisers	Reporting to fund board as required by 1940 Act, e.g., reports related to liquidity, derivatives, affiliated transactions, code of ethics
Monitoring portfolio management services, performance of subadvisers	Complying with Rule 38a-1 policies and procedures and providing reporting to the Primary Adviser, CCO
Implementing compliance procedures to ensure subadvisers comply with the fund's investment program	Responding to 15(c) materials requests; communicating with fund CCO and Primary Adviser CCO on a timely basis, attending board meetings
Continuing oversight of subadviser; initiating the termination of the sub-advisory relationship; changing a subadviser in a manager-of-managers structure	Maintaining books and records with respect to the securities transactions of the fund, and as otherwise required by the securities laws

In sum, selecting the subadviser can be a collaborative process between the board and management. Directors are better positioned when informed of management's plans as early as possible to enable the board to make its determination that hiring the subadviser is in the best interests of the fund and its shareholders. The board's communications with the CCO are important in order to gather information, ask questions and evaluate the Primary Adviser's due diligence process and criteria for selecting or rejecting subadviser candidates.

How is the Subadviser Approved?

When it comes to approving a new subadviser, there are two primary functions for the board. First, approving the sub-advisory contract, as required by Section 15(c) of the 1940 Act. Second, approving the subadviser's compliance policies and procedures under Rule 38a-1 of the 1940 Act. The board's approval of the initial sub-advisory contract likely will be informed by the Primary Adviser's due diligence process, reports on the subadviser's compliance operations, reports on its performance record on managing similar funds or strategies, and other data, including from third parties. Boards with the help of counsel should feel comfortable requesting additional information and in-person meetings with subadviser representatives before approving the initial sub-advisory contract. Once the subadviser is hired, the contract approval process continues as a yearlong undertaking, as directors may find that data gathered from reports and board meetings throughout the year will contribute to their annual evaluation of the sub-advisory contract and the services provided. The board's role is not to substitute its judgment for management's but to assess whether subjective factors are applied through a reasonable and well documented process.

The board's process for continuing approval of the sub-advisory contract is likely to parallel the process by which it otherwise reviews a contract with the Primary Adviser and will generally include consideration of many of the same factors and considerations.

Questions for Boards to Consider:

- What is the Primary Adviser's process for determining the subadviser's role when new regulation is adopted?
- How will the subadviser's adherence to certain rules and regulations be monitored, e.g., tax compliance under Subchapter M of the Internal Revenue Code, liquidity rule limitations, limited derivatives user exception?

Boards can expect to see the same types of materials from the subadviser as the Primary Adviser provides in the 15(c) process, such as fee information, and reports regarding the subadviser's compliance program, portfolio trading practices, cyber incident responses, business continuity programs and financial reports. Recently, these reports have begun to include information about artificial intelligence usage. Where multiple subadvisers are involved – and particularly in the context of manager-of-managers structure – a standardized questionnaire and information-gathering process can help boards efficiently manage and review materials before board meetings. There may be additional considerations when approving a subadviser's contract. Boards, for example, may wish to review with their counsel and the Primary Adviser the appropriateness of the Primary Adviser delegating certain advisory duties to a subadviser, particularly with respect to SEC regulations.

Legal Requirements

The 1940 Act requires that the sub-advisory contract be in writing, that it meet the requirements imposed by the 1940 Act on advisory contracts, and that it be approved by the board. The board must therefore decide whether to enter into a sub-advisory contract (and determine whether to renew the sub-advisory contract) pursuant to the legal standards that govern its review of the contract between the fund and the Primary Adviser.[9]

The sub-advisory contract, like the fund's advisory contract, must be approved initially and, after an initial two-year period, annually reapproved by a majority of the entire board and the independent directors, with votes cast in person at a meeting called for that purpose.[10] The board must also disclose the factors it considered when approving or reapproving the sub-advisory fee in public reports filed with the SEC following the approval or reapproval of the sub-advisory fee.[11]

For more on the advisory contract, please see MFDF's four-part white paper on the 15(c) contract approval and renewal process, including the board's process, the Gartenberg factors, SEC enforcement and private litigation matters.

Investment Performance

Oversight of a subadviser's investment performance is a significant part of the contract approval process and boards may devote appreciable amounts of time and resources (including dedicated committees) to conducting investment performance reviews. When approving the initial sub-advisory contract, a board will receive data and reports on the subadviser's performance track record managing a similar strategy. In addition to the subadviser's reports, boards can also request information from third-party consultants. The subadviser should provide data that is comprehensive, accurate and verifiable. Boards can also request written reports, in-person presentations, and executive summaries, as warranted.

Evaluating any fund's performance goes beyond the mere numbers. Over its life cycle a fund can remain in the top performance rankings for a long stretch followed by periods of lagging performance. A fund board can raise concerns with the Primary Adviser over fund underperformance (or over-performance) and concerns with the subadviser's handling of its duties and its adequacy of resources. **Directors may wish to consider the subadviser's stated perspectives on how they identify investment opportunities and manage risk and can use the performance data and attribution analysis provided to evaluate whether fund performance is consistent with the fund's investment objective and principal investment strategy.**

Measuring Profitability

Profitability information may not be as accessible from subadvisers, as compared with the Primary Adviser. For unaffiliated subadvisers, some boards may find it reasonable to place less emphasis on a

subadviser's profitability, instead focusing on whether it appears that the proposed sub-advisory fees have been negotiated in a true arm's length negotiation with the adviser. For funds with multiple subadvisers, boards may receive reports on profitability that vary widely in how each subadviser determines profitability. There is also a wide variety of practice in the degree to which subadvisers are willing to share their profitability data. New subadvisers may not have any profitability information to share. Boards should note that while each subadviser may weigh factors differently in making their profitability determinations, the clarity and reasonableness of the content of each report are more important than conformity among different subadvisers. Moreover, boards are not required to impose uniform profitability methodologies across subadvisers where doing so would be impractical, provided the information presented is sufficiently clear to support a reasoned judgment.

Subadviser Fees

Boards should be provided with adequate information to understand the rationale for the sub-advisory fee and the split between the Primary Adviser and the subadviser. In the most common arrangement, the Primary Adviser contracts with the subadviser and pays the subadviser out of the advisory fee received from the fund. In other cases, the fund is also a party to the contract and the subadviser is paid directly from the fund's assets. Arrangements with funds that limit their shareholders to qualified clients, as defined in the Investment Advisers Act of 1940[12], may include incentive and other performance-based fees.

Board considerations for evaluating sub-advisory fees

- Compare the fees paid under the sub-advisory contract to fees the subadviser charges to other sub-advisory clients (if data is available) or institutional accounts with similar strategies.
- Consider fees paid to other subadvisers by other similar funds in the complex or in other manager-of-managers complexes; or, for a new subadviser, fees negotiated with other subadviser candidates.
- Consider how the fees charged by the subadviser compare with those it charges for any advisory services with similar investment strategies.
- Consider unique cost, comparably higher advisory fees (e.g., lower asset levels, out of favor asset classes, higher redemptions, etc.).

While the board may reasonably expect that there has been arm's length bargaining in the case of an unaffiliated subadviser, directors still exercise diligence in their evaluation of the fee paid to unaffiliated subadvisers under the sub-advisory agreement. This is because the Primary Adviser itself, rather than the fund, may benefit when the Primary Adviser negotiates a lower sub-advisory fee, particularly when the sub-advisory fee is not paid directly by the fund. **A board may wish to consider whether some of the Primary Adviser's savings from a lower sub-advisory fee should be shared with shareholders**

alongside consideration of maintaining incentives for the Primary Adviser to negotiate the advisory fee on behalf of fund shareholders.

For a fund that uses multiple subadvisers, the board may seek to understand the framework used by the adviser to allocate assets among subadvisers that manage similar strategies, including how the adviser evaluates cost, performance, capacity, and other relevant factors. Where subadvisory fees differ, the board can make inquiries into how the adviser's allocation process addresses potential incentives to favor lower-cost managers and can maintain a record of its consideration of these matters.

In a manager-of-managers structure, subadvisers typically contract with and are paid by the Primary Adviser. The Primary Adviser has some leeway with reallocating fees among subadvisers in this context. But, SEC guidance that has been implemented in the conditions of typical manager-of-managers exemptive orders requires a shareholder vote to approve any new sub-advisory contract or any amendment to an existing primary advisory or sub-advisory contract that directly or indirectly results in an increase in the aggregate advisory rate charged to the fund.[13]

Over the last two decades, civil litigation under Section 36(b)[14] of the 1940 Act saw plaintiffs claiming, among other things, that investment advisers who use subadvisers charged excessive fees to their investors. From 2000–2018, the plaintiffs' bar initiated twenty-nine section 36(b) lawsuits, however no new section 36(b) lawsuits appear to have been filed since 2018.[15] In several of these lawsuits plaintiffs alleged that the Primary Adviser delegated the majority of its advisory responsibilities to one or more subadvisers and that the portion of the overall advisory fee retained by the Primary Adviser was "excessive" in light of the services that the Primary Adviser actually provided.[16]

Subadviser Reporting

Affiliated Transactions:

Boards receive summary reports of certifications from the CCO to assist in the board's determination that each affiliated transaction was conducted in accordance with the relevant 1940 Act rule and applicable policies and procedures.

Code of Ethics:

Subadviser must provide certification that it has adopted procedures reasonably necessary to prevent violations.

Subadviser must provide at least annually, a written report that describes issues arising under the code of ethics since the last report, including material violations and resulting sanctions. Subadviser must also inform the board of material changes to their code of ethics, which the board must approve no later than six months after changes adopted.

Rule 38a-1 Approvals:

Boards review and approve compliance policies and procedures of the subadviser initially pursuant to Rule 38a-1, and review them at least annually.

Boards may wish to seek some rational or objective basis for assessing the reasonableness of a sub-adviser's fees. See the text box above for considerations in assessing subadviser fees. Because of the differences in services rendered to a subadviser's proprietary funds where it acts as the primary adviser, comparing sub-advisory fees to the fees the subadviser charges to its proprietary funds may or may not be useful. Boards may rely on the inherent arm's length nature of the negotiations over fees between advisers and sub- advisers unless there is evidence to the contrary.

Approving the Subadviser's Compliance Program

In addition to approving the sub-advisory contract, boards approve the relevant compliance policies and procedures of the subadviser, including those addressing the following important areas of compliance—portfolio management, trading practices, proxy voting, personal trading (e.g., a Code of Ethics), and business continuity. These requirements are found in Rule 38a-1 and Rule 17j-1 of the 1940 Act. **Directors rely on the fund CCO to learn about the proposed subadviser's policies and overall compliance program, because the board's approval must be based on a finding that the policies and procedures of the subadviser are reasonably designed to prevent violations of the applicable federal securities laws.** The fund CCO also will want evidence that the subadviser's policies have been effectively implemented.

What are Key Factors in Ongoing Oversight?

Boards continue to oversee the sub-advisory relationship even as they grow familiar with the subadvised fund and representatives of the subadviser. Boards can seek insights into how the Primary Adviser and the fund CCO oversee the subadviser and where and how Rule 38a-1 compliance functions are performed. Boards also may want to gain insights from the fund CCO on its ongoing interactions with the subadviser, request meetings with portfolio managers, and pay close attention to investment performance, compliance and other reports. The fund CCO's role is to be the board's eyes and ears at the Primary Adviser and the subadviser.

Oversight of Compliance, Risk, and Operations

Communication between the board and CCO is critical for effective oversight of a subadviser's compliance, risk, operations, and other functions. Boards may prioritize candid and robust executive sessions with the CCO and communications between the board meeting cycle to foster a collaborative and transparent relationship.

Questions for Boards to Consider:

- How often will the CCO conduct on-site or virtual visits to the subadviser?
- Does the fund CCO have adequate access to the subadviser's CCO and other compliance, risk, operations, trading, and portfolio management personnel?
- What is the escalation process when the subadviser delays or is non-responsive in responding to board inquiries or requests?

The fund CCO may have limited access to a subadviser's detailed compliance information, particularly in the case of unaffiliated subadvisers. Nonetheless, the board can expect the CCO to be familiar with the subadviser's compliance procedures that are likely to be pertinent to a fund, including those governing soft dollars, valuation, cross trades, and proxy voting, to make sure they are acceptable for the fund. The CCO also should have a basic understanding of the subadviser's testing program, require timely notification of any exceptions, and be comfortable with the representations. Establishing a working relationship with the subadviser's CCO can help the fund CCO to achieve this. All of this will position the fund CCO to make the necessary findings required by Rule 38a-1 as to the design of the subadviser's policies and procedures and the effectiveness of how they are implemented.

The fund CCO typically will not have real-time access to a subadviser's activities, so will need to rely on data available through the fund's custodian (e.g., trading and portfolio compliance data, which is

provided on a delayed or post-trade basis), as well as ad hoc and regular reporting from the subadviser. For example, the fund CCO may obtain monthly or quarterly compliance certifications and reports, as well as conduct periodic on-site or virtual visits to the subadviser. Directors also need to appreciate that there are likely to be compliance missteps over the course of a given year, some of which may be material. These missteps do not necessarily mean that a given compliance program is materially weak, but rather that there may be a need for additional controls or education to increase the operational effectiveness of a given policy. Directors may wish to note when the compliance matters were identified by the subadviser's personnel, which demonstrates that the subadviser's compliance testing or surveillance programs are effective or that a good culture of compliance exists.

Oversight and reporting activities and practices will vary for each fund complex. Larger complexes may have dedicated vendor management programs and personnel that address subadviser oversight as part of a sophisticated third-party oversight function. CCOs may rely on those vendor oversight programs and their representatives to receive reports and to communicate with the subadviser. In a smaller fund complex, the CCO may have a more hands-on role in initiating communications and maintaining access to the subadviser. In addition, subadvisers with limited or no prior experience with the 1940 Act requirements and subadvisers managing complex or alternative strategies that implicate liquidity, leverage and valuation issues, may warrant a more tailored oversight approach and deeper scrutiny from the fund CCO and the board.

Oversight of Compliance, Risk, and Operations – Specific Considerations

What follows are some recommendations for ongoing board oversight of various areas, which will involve collaboration and communication with the Primary Adviser, fund CCO, transparent reporting and diligent review by the board.

Ongoing Performance Oversight

Throughout the year, boards receive performance reports comparing the fund's performance to market indices and to the fund's peers. Directors can look into how the subadviser's performance is monitored by the Primary Adviser, including the benchmarks used (which may not be the same as the fund's benchmarks). To address poor performance, directors can request robust attribution analysis and candid explanations from management; how long the subadviser expects underperformance to continue and whether the Primary Adviser has any plans to address the underperformance. Underperformance can result from numerous issues such as fees and expenses that cause performance drag; poor security selection; unfavorable market conditions or timing; sector concentration in underperforming sectors; investments in higher volatility asset classes; and inapt benchmark selection.

Understanding how a fund is likely to perform during certain market conditions and in relation to peers is key, as is getting attribution data from the portfolio manager. For funds that consistently underperform their benchmarks for multiple years, the board may wish to discuss with the Primary Adviser whether a remediation or other action plan is necessary, for example placing funds on watchlists. For outperforming funds, boards may want to discern whether certain risks were incurred or whether the existence of conditions unlikely to recur (such as access to an IPO) drove the performance.

Affiliated Transactions

As noted above, the 1940 Act prohibits certain transactions between funds and their affiliated persons, which includes the fund's subadviser. The SEC adopted a series of rules[17] that exempt certain entities, including subadvisers and their affiliates, from the restrictions and permit funds to enter into transactions with subadviser affiliates[18] when certain conditions are met.[19] Boards, working with the fund CCO, can seek assurances that the appropriate policies and procedures required for these transactions have been established at the subadviser. Boards should receive periodic reports or certifications from the fund's CCO showing that the required reviews and assessments have been conducted for these affiliated transactions.

Portfolio Trading

The Primary Adviser and fund CCO will have established practices to monitor the subadviser's trading activities, including its adherence to investment guidelines, and policies regarding brokerage and trading commissions. Based on CCO reporting, boards may learn more and ask questions regarding the subadviser's policies and procedures regarding allocation of investment opportunities and aggregation of trades that seek to protect the fund from being disadvantaged or the subadviser from improperly benefiting from its trade allocations. Other potential conflicts of importance include whether and how subadvisers engage in affiliated transactions such as cross trades. The CCO will provide the board with written reports on transactions where the risk of conflicts of interest is high, including on brokerage transactions conducted through affiliated brokers. The fund's CCO also is required to provide quarterly representations representing that affiliated transactions were conducted in accordance with the 1940 Act.[20]

Best Execution and Soft Dollars

An adviser's use of fund brokerage commissions to obtain research presents a potential conflict of interest, therefore fund boards are required to evaluate whether the adviser's use of these commissions are in the best interest of the fund. The fund CCO should review the subadviser's practices to seek and measure best execution, including any soft dollar arrangements and the subadviser's process for allocating commission dollars. A subadviser should not engage in any (even otherwise permissible) soft dollar practices that do not comply with the fund's policies and procedures. Additionally, the subadviser should periodically be asked to represent to the fund CCO that it has complied with its procedures. In order to evaluate how the subadviser approaches its transaction costs, the board can ask for reporting, including transaction cost analyses, to compare the subadvised funds' transaction costs to other transactions.

Valuation of Securities

While valuation has traditionally been a fund board responsibility, the SEC's Valuation Rule adopted in 2020 (Rule 2a-5 under the 1940 Act) revamped how advisers and boards can approach fund valuation. Rule 2a-5 permits boards to designate some or all of their fair valuation determination duties to a "valuation designee," which in most cases will be the Primary Adviser. A fund's subadviser cannot serve as a valuation designee, however boards or their valuation designee can seek the assistance of subadvisers for some valuation duties, including recommending pricing services and providing independent pricing evaluation reports, and performing back-testing and calculations. For most fund complexes the Primary Adviser serves as the valuation designee and will provide reporting on the valuation process to the board. For funds with multiple subadvisers, the Primary Adviser should have a mechanism in place to assess the valuations assigned to the same securities managed by different

subadvisers. The board can ask to be kept informed of valuation issues that arise for each subadvised fund, for instance difficulty in valuing a security that has not traded over an extended period. Boards also may seek to understand how the valuation designee challenges, corroborates, and reconciles valuation inputs received from each subadviser, particularly where different subadvisers hold similar positions on behalf of a fund. Directors may also wish to ask the CCO to monitor and report on the subadviser's price challenges. The Valuation Rule provides that a fund board should understand the role of and inquire about conflicts of interest regarding any service providers used by an investment adviser, including subadvisers, and satisfy itself that any conflicts are being appropriately managed.[21] For funds with private equity investments, boards may note that valuation inconsistencies may occur frequently.[22]

For more detailed guidance on the Valuation Rule, please see MFDF's white paper on Practical Guidance for Fund Directors on Valuation Oversight.

Portfolio Liquidity

Rule 22e-4 under the 1940 Act generally aims to ensure that open-end funds, including mutual funds and ETFs but excluding money market funds, can continue meeting daily redemption requests. The rule requires, among other things, that mutual funds and ETFs establish a liquidity risk management program ("LRMP") and comply with a 15% illiquid investment limit. A fund's board, including a majority of the fund's independent directors, must approve the fund's LRMP and the designation of the fund's adviser or officer(s) to administer the program. The SEC staff has permitted,[23] subject to appropriate oversight, a fund's subadviser to be designated as the liquidity program administrator if appropriate; and the responsibility for determining the liquidity classifications of the fund's investments may also be delegated to the subadviser.[24] While liquidity determinations are ultimately held at the fund level, funds with multiple subadvisers may see varying liquidity classifications for certain investments and boards may be presented with multiple reports that include varying classifications. The SEC staff has determined that when different managers within one fund classify the liquidity of an asset differently, the fund does not need to resolve the discrepancy for purposes of complying with the Liquidity Rule. Nevertheless, the fund must report a single liquidity classification to the SEC and should adopt policies and procedures for selecting which classification will be reported.

Liquidity Rule Reporting

Annual and interim reports (with fund liquidity classifications) from the Liquidity Risk Management Program administrator.

Reports on the highly liquid investment minimum, changes to the highly liquid investment minimum.

Periodic reporting regarding breaches and action plans for correction, general market liquidity commentary, liquidity classifications by individual holdings and classification buckets, liquidity classifications with trend analyses; vendor status, material redemption activity and the results of back testing.

Derivatives Rule

Open-end funds, including mutual funds and ETFs but excluding money market funds, and closed-end funds and business development companies (BDCs) are subject to the Derivatives Rule (Rule 18f-4 Rule under the 1940 Act). The boards of such funds will want to understand the role of the subadviser under any derivatives program and that any policy is clearly delineated and that the CCO and Primary Adviser are carefully monitoring subadviser compliance. Rule 18f-4 Rule requires that funds develop a derivatives risk management program ("DRMP") and that the fund board approve a derivatives risk manager ("DRM"). A single subadviser may serve as a fund's DRM, or officers of the subadviser could serve on a committee that acts as the fund's DRM, together with, or without, representatives from the Primary Adviser. In practice, it is more common for the Primary Adviser to serve as the DRM with coordination among subadvisers to ensure consistency across funds.

Derivatives Rule Reporting

Reporting upon/before implementation of derivatives risk management program, and at least annually.

Representation that the DRMP is reasonably designed to manage derivatives risks and to incorporate Rule 18f-4 requirements, and the basis therefor.

Effectiveness of the DRMP's implementation.

Basis for determinations regarding designated reference portfolios.

Regular reports (with frequency determined by the board) of DRM's analysis of exceedances of guidelines, stress testing and back-testing.

Additional reporting if a fund exceeds VaR test for more than 5 business days.

A fund may delegate to the subadviser (who is not the DRM) certain derivatives risk activities such as risk identification and assessment, compliance with risk guidelines and preparing stress testing and back testing.[25] Certain activities cannot be delegated, however, including determining which Value at Risk (VaR) Test Limit to apply, and the escalation of material risks and reporting to the fund's board. For multi-manager funds, a subadviser of a sleeve of fund assets cannot serve as the DRM, as many aspects of the derivatives risk management program relate to the entire fund, particularly VaR testing and stress testing.[26] The fund board will have to review both the Primary Adviser's and each subadviser's written policies and procedures under the Derivatives Rule and review each subadviser's periodic and annual reports. **Board concerns under the derivatives rule include whether the subadviser is complying with the appropriate limits on fund leverage risk, whether the board is receiving adequate reporting on the frequency and results of stress testing, and whether the board is quickly involved in the process when limits are breached.** For subadvisers that limit their exposure to derivatives to under 10 percent, boards may wish to determine whether the fund's policies and procedures make the subadviser responsible for

compliance with the exposure limits pursuant to the rule's requirements.[27] For multi-manager funds, boards may seek to understand how responsibility is allocated when derivatives-related breaches arise from a particular sleeve but have fund-level consequences.

Fund of Funds Rule

In 2020, the SEC adopted Rule 12d1-4 under the 1940 Act,[28] which generally expands the types of permitted fund-of-funds structures and allows, subject to specific conditions, a mutual fund or BDC to acquire the securities of any other registered fund or BDC in excess of the limits imposed under Section 12 of the 1940 Act without obtaining an individual exemptive order. Boards may wish to discuss with counsel and the fund CCO the Primary Adviser's responsibilities under Rule 12d1-4 and potential conflicts of interest associated with fund-of-funds agreements. If a subadviser to a fund-of-funds will be permitted to invest in its proprietary funds under the arrangement, boards will want to determine that the advisory fees are appropriate and not duplicative. Boards also may ask about the subadviser's fulfillment of its responsibilities under Rule 12d1-4 and potential conflicts of interest.

Exchange-Traded Funds

The ETF rule adopted in 2019[29] does not directly impose obligations on ETF boards, however the SEC has suggested that an ETF board's oversight of the ETF's compliance policies and procedures, as well as its general oversight of the ETF, would provide an additional layer of protection for an ETF's use of custom baskets.[30] With the CCO's assistance, boards may wish to monitor reporting on how the subadviser is adhering to policies and procedures in the custom basket construction process and the administration of custom baskets. Boards may also wish to ask the subadviser how it plans to handle in-kind transactions and what its efforts are to mitigate bid-ask spreads.

Proxy Voting

Fund complexes that use subadvisers take different approaches to proxy voting. Some Primary Advisers develop and administer policies and procedures and vote proxies on a centralized basis for all funds in the complex, frequently with the assistance of, or following guidelines established by, a third-party proxy voting service. Boards of funds with centralized proxy voting may want to consider whether subadviser input on proxy voting decisions is appropriate generally and particularly in cases where the Primary Adviser has a potential conflict, for example, because of a relationship with a portfolio company. Some fund complexes delegate to subadvisers proxy voting for the fund portfolio holdings under their management. Other complexes are beginning to allow shareholders the ability to provide proxy voting instructions for the shares they own. Over the last decade, there has been increasing regulatory focus on proxy voting, coupled with increasing focus from shareholders, which has prompted many boards to revisit the proxy voting policies and procedures that apply to their funds. Boards of subadvised funds may seek to understand the subadviser's proxy voting policies and engagement practices vis-à-vis the fund's disclosed strategies, particularly in the case of impact strategies.

Questions for Boards to Consider:

- Will the subadviser construct and/or approve custome baskets for ETFs?
- With respect to the Liquidity Rule, does the LRMP reflect an approach that considers input from both the Primary Adviser and subadviser and establish a method for resolving differences in liquidity classifications?
- Will the Primary Adviser rely on the subadviser for portfolio allocation limitations?
- Will the subadviser be responsible for voting proxies on behalf of the fund?

In 2025, an executive order[31] directed the SEC to take significant steps designed to limit the influence of the two predominant proxy advisory firms generally, and specifically with respect to voting proposals that implicate "diversity, equity, and inclusion" and "environmental, social and governance" matters. Boards of subadvised funds can ask proxy advisory firms, how the Primary Adviser and sub-adviser policies and procedures align with fund and shareholder interests, and any risks or conflicts of interest presented by the executive order. Boards of subadvised funds will also want to monitor the subadviser's compliance with SEC rules around disclosures and fund filings requirements. In 2022, the SEC adopted amendments[32] to Form N-PX under the 1940 Act to enhance the information that funds currently report about their proxy votes and to make that information easier to analyze. Boards will want to work with the CCO and counsel to ensure that subadvisers are complying with the SEC's requirements on reporting and disclosures of their voting information.

Risk Management Oversight

Subadvisers are among the third-party service providers in a fund complex that present business, reputational and other risks to a fund. The SEC has emphasized the importance of third-party vendor oversight in its examination priorities and outlined numerous risk areas for market participants, including operational resiliency, information security and compliance programs.[33] A board may wish to request that subadvisers submit materials during the 15(c) process that address the subadviser's business resilience, cyber and data security programs, insurance coverages, internal audit reports, and SOC-1 or SOC-2 reports, if any.[34] The board may wish to ask the CCO ongoing questions on the CCO's impressions of the subadviser's business environment, culture, and whether the subadviser has a satisfactory and systematic approach to risk management.

For more detailed guidance on risk management, please see MFDF's white paper, Role of the Fund Director in the Oversight of the Risk Management Function.

Cybersecurity and Data Protection

An adviser's cybersecurity and investor data protection program remain critical areas of oversight for fund boards, as cyber risks do exist around the fund's portfolio and trading data (to the extent that the

fund does not provide full transparency of its portfolio). The extent of cybersecurity risk at the subadviser may be limited to investment data since shareholder information is generally kept at the Primary Adviser or transfer agent. Still, boards can expect to review or receive reports from the CCO on a subadviser's cybersecurity program and its policies and procedures at least annually, but a subadviser should communicate near-time information on material cybersecurity incidents potentially affecting a fund. The CCO or other management representatives will likely provide reports on ongoing oversight of the subadviser's cybersecurity program, reports and presentations regarding incidents and responses, and information on cybersecurity insurance coverage, if applicable.

Technology and Artificial Intelligence

The use of technology in fund operations, trading, and other functions is changing the asset management business rapidly and introducing risks associated with the use of emerging technologies and alternative sources of data. Boards may wish to receive regular reporting on the subadviser's investments in and use of automated investment tools, AI and similar technologies, and trading algorithms or platforms. For subadvisers who use algorithmic trading, boards may also wish to see reports on risk management controls to gain comfort that the subadviser is making the appropriate disclosures to investors and regulators. Boards may wish to monitor with the CCO whether the subadviser's representations on the use of these technologies are accurate and that the subadviser's operations and controls are consistent with disclosures made to investors and with regulatory obligations.

Boards will want to know where a subadviser is deploying artificial intelligence in its business and the risks involved insofar as they may affect the fund. If AI is being used to modernize the subadviser's back-office operations, the board may wish to know the risk management controls in place and that staff are trained appropriately.[35] Not every technology implementation warrants board attention, and establishing materiality in technology oversight is important. **Boards may direct their focus on AI applications that materially affect the subadviser's ability to execute its mandate; investment performance and risk management; potential conflicts disadvantaging the fund investors; and business model shifts redirecting resources away from fund management Here, the role of the CCO and other management representatives, such as the chief information security officer, is to help the board filter technological developments and establish clear notification thresholds.** If AI is deployed in non-investment operations (such as staff training, client reporting, compliance monitoring, trade execution, or back-office functions) the board may ask questions regarding the subadviser's data governance processes and protection of sensitive fund and shareholder information and safeguards against algorithmic errors and bias in compliance functions. AI uses in areas that are still developing, such as investment model development, alternative data analysis, portfolio construction, risk management and more, require special attention in subadviser due diligence and ongoing monitoring. Materiality around impact to investment outcome and risk management is critical, as boards may want to focus on only the most important high-level oversight areas. Boards may want to engage with the

Primary Adviser's information technology/data security group to understand the Primary Adviser's oversight program for subadvisers generally and those utilizing AI in particular.

Alternative Assets and Complex Products

As the registered fund industry looks to a more diverse slate of products, a subadviser that focuses on alternative assets and novel, complex and niche products can add those elements to a fund complex. The fundamental responsibility of the board to act in the best interests of the fund and its shareholders does not change with alternative assets and complex products. At the same time, directors of these types of funds may pay closer attention to valuation, leverage, and liquidity, among other portfolio management issues. **Compared to traditional mutual funds, an alternative fund board may also be more concerned with a subadviser's expertise and track record managing the type of assets involved and their ability to comply with the 1940 Act, particularly if the subadviser's prior experience is primarily as an adviser to private funds. But even traditional mutual fund and ETF boards may want to focus on where a subadviser is being engaged to manage private, tokenized, or other alternative types of assets.** Boards with the help of the fund CCO and counsel may wish to develop and regularly examine oversight policies and procedures to ensure they cover the characteristics of the alternative assets and complex products overseen by the board. At the subadviser hiring stage, the board may wish to ask the Primary Adviser to compile adequate information to afford comfort with the subadviser's competence and experience, its ability to comply with the securities laws, its performance track record, risk management protocols and management of operational risk, documentation, volatility, segregation of assets where required, collateral, and other related issues.

For more detailed guidance on alternative investment products and board oversight generally, please see MFDF's white paper, Practical Guidance for Fund Directors on Oversight of Alternative Investments.

Complex product types may present a learning curve for boards, as they present shareholder reporting, shareholder meeting, share repurchase and other practices and requirements that are not characteristic of traditional mutual funds and ETFs. For example, interval fund boards can monitor the different processes to implement periodic share repurchases, including how the repurchase offer terms and amount are consistent with the fund's fundamental policy and Rule 23c-1 under the 1940 Act. BDC boards may wish to understand the particular asset coverage requirements that apply under Section 61 of the 1940 Act. Some registered funds utilize offshore subsidiaries to make certain investments. Boards may wish to work with the CCO to ensure that any subadviser of an offshore subsidiary maintains its registration with the Commodity Futures Trading Commission, has claimed the appropriate exemptive status, and met other requirements.

Co-Investments

In a co-investment transaction, a registered fund invests alongside private funds and other closed-end funds, including BDCs, managed by the Primary Adviser or an affiliate or subadviser. Currently,

complexes wishing to participate in co-investment transactions must first obtain SEC exemptive relief (available to closed-end funds) from that affiliated transaction prohibitions of Section 17(d) of the 1940 Act. In 2025, the SEC began granting an updated form of co-investment relief that simplifies the co-investment process;[36] however, even the streamlined process requires oversight and action from a fund's board. For subadvised funds that participate in co-investments, boards can work with counsel to understand the parameters of the co-investment exemptive relief. In some cases, it may be that the subadviser runs the co-investment program rather than the Primary Adviser. Boards of subadvised funds that receive a proposal to approve a 17(d) exemptive application may wish to ask the Primary Adviser how the proposed co-investment program tracks fund investment mandates; how the board will be given adequate time to review co-investment proposals, including those with a shortened turnaround time; and how the board will receive comprehensive reporting as a follow-up to co-investment transactions.

Digital Assets

Asset managers are increasingly engaging with digital assets through direct investment, provision of services to the industry and tokenization (the process of converting an asset or the ownership rights of an asset to a digital form using blockchain).[37] Currently, investment options for advisers to obtain crypto exposure include holding cryptocurrency directly, investing in bitcoin or other cryptocurrency futures contracts, bitcoin and Ethereum spot ETFs, and other exchanged-traded products. Registered funds are not yet permitted to obtain physical exposure to cryptocurrencies, however boards may be interested in a subadviser's involvement in the digital assets industry and its exposure to crypto instruments. Digital asset exposure and related service provider arrangements can raise issues around custody, valuation, liquidity disclosure, and regulatory structure. Oversight considerations include whether the fund's exposure is direct or indirect (for example, via exchange-traded products not registered under the 1940 Act) and whether compliance and operational controls remain aligned with current SEC staff positions and market practice.

What is the Process When Changing, Terminating Subadvisers?

The recommendation to fire or switch out a subadviser sits with the fund's Primary Adviser. Even so, the board will need to approve the termination of the sub-advisory contract and approve any new sub-advisory agreement in accordance with the 15(c) process. Some boards, particularly in manager-of-managers complexes, can seek to initiate a change in subadviser. In all cases, boards will want to determine that the decision is being made in the best interests of the fund. The Primary Adviser may have several reasonable reasons for terminating a subadviser. For instance, a subadviser may be failing to meet the Primary Adviser's and the board's expectations with respect to performance; the Primary Adviser may believe that there are other subadvisers with stronger records in the asset class in which the fund invests; the Primary Adviser may believe that other subadvisers are equally strong but will be less costly to the fund, the Primary Adviser, or both; the fund and/or the Primary Adviser may be participating in a merger or reorganization involving a subadviser change; the subadviser may be experiencing compliance issues or have lost its eligibility under Section 9(a) of the 1940 Act; or there may be other problems in the relationship between the fund, the Primary Adviser and the subadviser. Particularly where a terminated subadviser is being replaced, the board may seek to understand why the new arrangement proposed by the Primary Adviser is preferable to the previous arrangement, and how the transition will be implemented (including whether a transition manager will be used), what effect the transition would have on existing shareholders (including any transaction costs and tax consequences driven by anticipated portfolio turnover), and how the portfolio will change.

Depending on the circumstances, changing a subadviser may necessitate in-person board meetings; interim agreement conditions; shareholder approval; compliance with exemptive order conditions; changes to aggregate investment advisory fees; registration statement updates; and impacts to shareholders such as transaction costs and capital gains.

Conclusion

Board oversight of subadvisers is a collaborative process among the Primary Adviser, the fund CCO, counsel and the board. While a board's statutory oversight responsibilities with respect to subadvisers are grounded in the same fiduciary framework as oversight of the Primary Adviser, in practice the board's oversight of subadvisers is exercised largely through its oversight of the Primary Adviser's supervisory framework and the fund CCO's reporting. This paper provides illustrative practices and questions and is intended to support a risk-based approach to oversight. The nature, depth, and frequency of oversight should be scaled to the subadviser's delegated responsibilities, the fund's strategy and complexity, the fund complex's compliance and operational structure, and any other relevant factors. Diligent inquiry from the board and transparency from the Primary Adviser and subadviser(s) are important to effective oversight. In our data-centric age, boards can expect both the Primary Adviser and subadviser(s) to provide visibility across compliance, risk, liquidity, valuation, and operations. Where limitations exist, boards can use the fund CCO, counsel and others to challenge and monitor as they seek to ensure that the fund is being managed in alignment with shareholder interests and compliance with the securities laws.

Endnotes

[1] This publication has been reviewed by MFDF's Steering Committee and approved by MFDF's Board of Directors, although it does not necessarily represent the views of all members in every respect. One representative from each member group serves on MFDF's Steering Committee. MFDF's current membership includes over 1267 independent directors, representing 167 mutual fund groups. Nothing contained in this report is intended to serve as legal advice. Each fund board should seek the advice of counsel for issues relating to its individual circumstances.

[2] For ease of reference, 'director' is used universally herein rather than 'trustee.' Funds have directors when their form of organization is a corporation, and trustees when their form of organization is a trust, but often the terms director and trustee are used interchangeably in the context of registered investment companies.

[3] See Rule 22e-4 (the Liquidity Rule), Rule 18f-4 (the Derivatives Rule) and Rule 2a-5 (the Valuation Rule) under the Investment Company Act of 1940, as amended.

[4] Section 2(a)(3) of the 1940 Act defines affiliated person.

[5] For example, Rule 17a-7 provides relief for different types of cross trades, allowing purchases and sales of securities between affiliated funds. Rule 17e-1 permits a fund's subadviser (or other affiliated person) to receive compensation for service as a broker, without complying with the recordkeeping and review requirements. Rule 10f-3, allows a fund to purchase securities in an affiliated underwriting. Also, in 2018, the SEC provided no-action relief permitting a fund's board to rely on written representations from the fund's CCO in lieu of quarterly determinations that the fund's transactions made pursuant to Rule 17a-7, Rule 17e-1 and Rule 10f-3 were effected in compliance with the fund's procedures. *See* Independent Directors Council, SEC Staff No-Action Letter (Oct. 12, 2018)

[6] Subadviser affiliates are persons that are affiliated persons of a fund solely because they are the fund's subadviser(s), affiliated persons of the fund's subadviser(s), or the subadviser(s) of other affiliated funds (for example, other funds in the fund complex). Section 2(a)3 of the 1940 Act. See also: Transactions of Investment Companies with Portfolio and Subadviser Affiliates, Investment Company Act Release No. IC-25888 (Feb. 24, 2003).

[7] Ibid.

[8] Section 2(a)(19) of the 1940 Act.

[9] Section 15(a) of the 1940 Act.

[10] Section 15(c) of the 1940 Act.

[11] See Disclosure Regarding Approval of Investment Advisory Contracts by Directors of Investment Companies, SEC Release IC-26486 (June 23, 2004). Some funds report this information pursuant to the Tailored Shareholder Rule in Annual or Semi-Annual Financial Statements and Other Information.

[12] Rule 205-3 of the Investment Advisers Act of 1940.

[13] See SEC IM Guidance Update, No. 2014-03 (February 2014), *See* also, Carillon Tower Advisers, Inc., et al., Investment Company Act Release Nos. 33464 (May 2, 2019) (notice) and 33494 (May 29, 2019) (order).

[14] Section 36(b), among other things, provides that a fund's investment adviser has a fiduciary duty with respect to the receipt of compensation for services paid by the fund to the adviser or any affiliated person of the adviser and that a shareholder may bring an action against that adviser for breach of that duty.

[15] Claims Trends: A Review of Claims Activity in the Mutual Fund Industry (January 2024–March 2025) ICI Mutual. https://www.icimutual.com/wp-content/uploads/Final-Claims-Trends-2024-2025-v2.pdf

[16] Section 36(b) Litigation Since Jones v. Harris. ICI Mutual Litigation Overview. https://www.icimutual.com/wp-content/uploads/Section-36b-Litigation-Overview.pdf

[17] In 2018, the SEC provided no-action relief permitting a fund's board to rely on written representations from the fund's CCO in lieu of quarterly determinations that the fund's transactions made pursuant to certain exemptive rules were effected in compliance with the fund's procedures. See Note 5.

[18] Subadviser affiliates are persons that are affiliated persons of a fund solely because they are the fund's subadvisers, affiliated persons of the fund's subadvisers, or subadvisers of other affiliated funds (for example, other funds in the fund complex). Section 2(a)3 of the 1940 Act. See also: Transactions of Investment Companies with Portfolio and Subadviser Affiliates, Investment Company Act Release No. IC-25888 (Feb. 24, 2003)

[19] Ibid.

[20] Independent Directors Council, SEC Staff No-Action Letter (Oct. 12, 2018) Also, See Note 5.

[21] "SEC Modernizes Framework for Fund Valuation Practices." https://www.sec.gov/newsroom/press-releases/2020-302

[22] "Inconsistencies Plague Private Market Valuations: PCAOB Committee." Ignites. September 30, 2025 https://www.ignites.com/c/4989674/688544?referrer_module=dashLatestNews&module_order=3

[23] Investment Company Liquidity Risk Management Programs Frequently Asked Questions. https://www.sec.gov/about/investment-company-liquidity-risk-management-programs-frequently-asked-questions

[24] Investment Company Liquidity Risk Management Programs SEC Release Nos. 33- 10233; IC- 32315; File No. S7-16-15

[25] Use of Derivatives by Registered Investment Companies and Business Development Companies. Release No. IC-34084; File No. S7-24-15

[26] Compliance with Rule 18f-4 by a Subadvised Fund. Perkins Coie. December 9, 2021 https://perkinscoie.com/insights/blog/compliance-rule-18f-4-subadvised-fund.

[27] Ibid.

[28] Fund of Funds Arrangements. SEC Release Nos. 33-10871; IC-34045; File No. S7-27-18

[29] Exchange-Traded Funds. SEC Release Nos. 33-10695; IC-33646; File No. S7-15-18

[30] Ibid at 91.

[31] See: Protecting American Investors from Foreign-Owned and Politically-Motivated Proxy Advisors. Executive Order. December 11, 2025. https://www.whitehouse.gov/presidential-actions/2025/12/protecting-american-investors-from-foreign-owned-and-politically-motivated-proxy-advisors/

[32] Enhanced Reporting of Proxy Votes by Registered Management Investment Companies; Reporting of Executive Compensation Votes by Institutional Investment Managers. Release Nos. 33-11131; 34-96206; IC-34745; File No. S7-11-21

[33] SEC Division of Examinations Announces 2026 Priorities. https://www.sec.gov/newsroom/press-releases/2025-132-sec-division-examinations-announces-2026-priorities. In 2024 the SEC adopted amendments to Regulation S-P, which govern how financial institutions, including registered fund companies and investment advisers, must safeguard the non-public personal information of customers. The amendments require investment advisers to, among other things, develop and maintain written policies and procedures addressing the safeguarding of customer information, incident response, service provider oversight, and recordkeeping.

[34] System Oversight Controls (SOC) reports describe a company's internal controls on financial reporting.

[35] SEC Division of Examinations Announces 2026 Priorities. https://www.sec.gov/newsroom/press-releases/2025-132-sec-division-examinations-announces-2026-priorities

[36] See FS Credit Opportunities Corp., et al., SEC No. IC-35561 (April 29, 2025) (order).

[37] New Paradigm: Remarks at SEC Speaks by SEC Commissioner Hester Peirce. https://www.sec.gov/newsroom/speeches-statements/peirce-remarks-sec-speaks-051925-new-paradigm-remarks-sec-speaks