Understanding The Roles of Independent Trustee, Fund and Adviser Counsel

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Why Are There Different Counsel Roles?

Unique Structure of Investment Company—Different from a typical corporation

• Generally no employees of own (with some exceptions)
  ➢ Separately owned and operated entity contracts with Fund to provide day-to-day management of fund operations
    ✓ Officers of Fund are generally employed and compensated by sponsor or other external service provider
    ✓ Sponsor may be the Adviser (or an affiliate) or the Administrator

• Investment company has its own shareholders distinct from those of management responsible for day-to-day operations
  ➢ *Interests generally aligned but management’s interest in maximizing its own profit for its owners may conflict with its fiduciary duty to act solely in the best interest of the Fund and its shareholders*
Investment Company Trustees Have Special Responsibilities

- **Difference in Fiduciary Duties from Corporate Directors**
  - Mutual fund trustees have greater duties than directors of operating companies due to the conflicts of interest in investment company structure.

- **Investment Company Act of 1940** imposes certain additional responsibilities specifically on the trustees who are not “interested persons” of the investment company or its affiliated persons.
  - Role of “Independent Watchdogs”

- It’s not just the **Investment Company Act of 1940**--
  - Complicated legal and regulatory framework includes: (i) Federal and state law and regulations; (ii) SEC orders, no-action letters and guidance; (iii) common law; and (iv) best practices and informal guidance.
Who are the Clients?

Different counsel represent the various interests in the investment company relationship

- Potential clients:
  1. The Independent Trustees
  2. The Fund
  3. The Adviser
  4. Other service providers (e.g., sub-advisers or Administrator)
Which Counsel Represents Each Client?

- **NO ONE SIZE FITS ALL**
  - Variety of combinations based upon facts and circumstances of individual fund complex
    - Size and complexity of complex, level of resources, historical practice

**Examples:**
- One firm serving as both Fund Counsel and Independent Trustee Counsel with separate Adviser counsel
- Separate Independent Trustee Counsel, Fund Counsel and Adviser Counsel
- Fund Counsel and Adviser Counsel same with separate dedicated Independent Trustee Counsel
- Fund Counsel with no dedicated Independent Trustee Counsel
Attorney duties to client

- Duty to zealously represent client
- Independent Trustee counsel has duty to ensure Independent Trustees are exercising their duties in best interests of Fund shareholders and consistent with applicable laws and regulations

Who bears cost of legal expenses? Fund or Adviser?

- Fund Counsel and Independent Trustee Counsel
- Adviser Counsel
- Expense limitation agreements
- Non-routine legal costs such as for fund reorganizations or special projects
The Important Role of Independent Trustee Counsel

- SEC has stated that it is important for Independent Trustees to have access to counsel who is free from conflicting loyalties, especially when they are called on to “exercise judgment in certain key areas of their responsibilities…” (2001 SEC rule release—Role of Independent Directors of Investment Companies)

- Strong defense if Independent Trustees challenged for Board actions
  - Courts have viewed reliance on independent counsel as evidence of Director independence
    - E.g., Gartenberg case and recent excessive fee cases—presence of Independent Trustee Counsel given significant weight
  - SEC considers consultation with experienced legal counsel to be sign of Trustee “due diligence”

- Industry Norm-- 91% of fund complexes report that Independent Trustees are represented by dedicated counsel or counsel separate from the adviser as compared to 64% in 1998. (ICI/IDC Overview of Fund Governance Practices, 1994-2016, October 2017. See https://www.ici.org/pdf/pub_17_fund_governance.pdf)
Who Qualifies as “Independent Legal Counsel”?

- 1940 Act does not require Independent Trustees to hire their own separate counsel. However, in order to rely on certain exemptive rules (such as Rule 12b-1), any attorney for the Independent Trustees must be “independent legal counsel.”

  - A person is considered to be independent legal counsel if the Independent Trustees determine that any representation by such counsel of the Fund’s investment adviser, principal underwriter, administrator (“management organizations”), or any of their control persons, during the Funds’ past two completed fiscal years is sufficiently limited that it is unlikely to adversely affect the professional judgment of the attorney(s) in providing legal representation to the Independent Trustees. (Rule 0-1(a)(6)(i)(A) of the 1940 Act)
    - Determination must be made at least annually.
    - Basis for determination must be recorded in the minutes of meeting.
    - Independent Trustees must obtain an undertaking from counsel to provide them with information necessary to make their determination and to update promptly that information when the person begins to represent, or materially increases his representation of, a management organization or control person.
    - “Person” means both the individual and his or her firm.
No specific test under SEC Governance Standards. SEC has stated that Independent Trustees should consider all relevant factors in evaluating whether the conflicting representations are sufficiently limited, including

- Whether the representation is current and ongoing;
- Whether it involves a minor or substantial matter;
- Whether it involves the fund, the adviser, or an affiliate, and if an affiliate, the nature and the extent of the affiliation;
- The duration of the conflicting representation;
- The importance of the representation to counsel and his firm (including the extent to which counsel relies on that representation economically);
- Whether it involves work related to mutual funds; and
- Whether the individual who will serve as legal counsel was or is involved in the representation.

SEC specifically indicated that Independent Trustees may conclude that a counsel's representation of a sub-adviser does not impede that counsel's ability to serve as independent counsel.

1940 Act Rule 0-1 states that Independent Trustees are “…entitled to rely on the information obtained from [independent legal counsel]…unless they know or have reason to believe that the information is materially false or incomplete.”
Primary Functions of Independent Trustee Counsel

- **Assist the Independent Trustees** in carrying out their duties and responsibilities under Federal and state law

- Advise on Board process, help prepare Board for meetings and ensure proper documentation of Board deliberations
  - “Issue spotting”
  - Provide guidance on how matters should be presented to Board
  - Review all materials submitted to Board

- Meet separately with Independent Trustees in executive sessions without management present to discuss Board and Fund matters

- Educate Board on best practices and fund industry emerging trends or issues

- **Review all 15(c) annual contract renewal materials and advise and assist Independent Trustees throughout the contract renewal process**

- Interact with Fund counsel and fund management on matters arising between meetings and act as liaison on any Board meeting follow-up matters
Primary Functions of Independent Trustee Counsel

- Attend all Board and Committee meetings, as well as executive sessions and any pre-board meeting calls
- Document Board deliberations in executive sessions and review Board and Committee meeting minutes
- Review Fund disclosure documents (e.g., annual updates to registration statements, shareholder reports, proxy materials), particularly any disclosure relating specifically to the Board and its deliberations
- Prepare memoranda to Board regarding their duties and on other matters, including legal and regulatory developments
- Assist with communications between meetings among the Independent Trustees and management
- Monitor and participate in any litigation matters and represent Independent Trustees before SEC and other regulatory organizations
Representative Independent Trustee Counsel Matters

- Board governance and operational matters such as agenda setting, Trustee compensation, chair and committee leadership nominations, Board self-assessments, Trustee retirement policy, new Trustees
- D&O/E&O insurance policies and Fidelity bonds, indemnification, limitation of liability
- Compliance (including CCO and oversight of service providers)
- Issues relating to particular types of funds (e.g., funds of funds, umbrella series trusts, alternative, money market, master/feeder, international, closed-end, ETFs)
- Arrangements with affiliates and affiliated transactions, monitoring for real or potential conflicts of interest
- Oversight of risk management, cybersecurity
- New regulation such as fund liquidity management program rule
- Distribution arrangements, including Rule 12b-1 plans, omnibus accounts and revenue sharing
The Role of Fund Counsel

- Represents the Fund in connection with the legal matters relating to its operations
  - Provides continuous legal advice on behalf of the Fund under Federal and state law, including with respect to fund transactions, compliance issues, product development and valuation
  - Broader role than Independent Trustee counsel role

- Advises on Fund regulatory and compliance matters

- Responsible for registration and disclosure matters, including representing Fund before the SEC staff

- May advise on business issues

- May be requested to undertake special reviews or research on legal matters that arise in the course of the Fund’s operations

- Works closely with management personnel on a day-to-day basis
  - Fund counsel must act in best interests of its client, the Fund

- May be asked to work on specific project for Adviser—e.g., has special expertise or work is related to Fund
Examples of Fund Counsel Duties

- Preparation of regulatory filings (e.g., SEC registration statements and “stickers,” and proxy statements)
  - Includes monitoring legal, regulatory and market developments and drafting any new disclosure required

- Assisting in the preparation of Board materials

- Attending Board and Committee meetings and advising the full Board and Fund officers on their duties and responsibilities with respect to contemplated actions

- Negotiation and documentation of contractual relationships with third-party service providers

- Assist in connection with non-routine events, including any litigation matters or regulatory examinations or investigations

- Advising on and assisting in preparation of the documentation for fund transactions, including launches, liquidations, mergers and acquisitions

- Providing advice with respect to distribution arrangements

- Advising and negotiating documentation for fund portfolio transactions such as derivatives transactions
The Role of Adviser Counsel

- Client is the Adviser.
  - Adviser also has fiduciary duty to Fund

- Adviser’s in-house attorneys (internal counsel) may perform many of the day-to-day legal functions relating to the Fund.
  - Coordinate with activities of Fund Counsel
  - Communicate with Independent Trustee Counsel

- May engage its own counsel, including for non-routine projects, in situations where there is a potential conflict of interest, or in connection with regulatory or litigation matters.

- In addition to work done for the Fund, Adviser counsel also advises the Adviser on its own business and legal matters.
Examples of Adviser Counsel Duties

- Legal analysis and advice on all matters affecting Fund, including portfolio management and product development, investment strategy changes, compliance and valuation matters
- Perform legal functions related to fund launches, liquidations, mergers and acquisitions and with respect to closed-end fund matters such as IPOs, borrowing agreements and shareholder meetings
- Legal functions related to Board and Committee meetings, including preparation of Board books, trustee and officer questionnaires, legal calendars and recordkeeping
- Preparation of Fund regulatory filings such as annual updates to registration statements and shareholder reports and interface with regulators
- Representation on various control-function committees such as valuation committee, disclosure committee (Sarbanes-Oxley), complex securities committee
- Respond to SEC examination requests
- Distribution matters such as negotiating intermediary contracts or revenue sharing issues or share class additions
- Drafting or review of service provider contracts and oversight of third party service providers
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Stacy is a partner in the firm’s nationally ranked Investment Management Practice Group. Her national practice focuses on the representation of registered investment companies and their independent directors and investment advisers. Over the past nineteen years, she has advised clients on a broad range of matters relating to the operation of investment companies, including the organization and offering of open-end and closed-end investment companies, mergers of individual mutual funds and of fund complexes, and board governance, compliance and other regulatory matters under the federal securities laws. She has served as fund counsel and/or counsel to the independent directors of fund complexes of all sizes, including a number of large and well-known fund groups. She has extensive experience in counseling independent directors/trustees on matters relating to board governance and best practices, as well as with respect to their duties under the Investment Company Act of 1940. Stacy regularly counsels and assists independent directors in their annual 15(c) contract approval process and advises on topics such as board governance best practices, distribution, D&O insurance, and risk management oversight. She has substantial experience relating to different registered fund products, including variable annuity insurance funds, funds of funds, manager of managers structures, umbrella series trusts, alternative investment funds, master-feeder funds and money market funds. Stacy also regularly counsels clients on regulatory and industry matters, including with respect to the DOL fiduciary, fund liquidity risk management program and money market fund reform rules. Stacy has been consistently recommended in the area of Mutual/Registered Funds law in The Legal 500 United States. She received her J.D. from Washington & Lee University and her B.A. from The University of North Carolina at Chapel Hill.