

**MULTI-MANAGER FUNDS - AGGREGATE ADVISORY FEE RATE**

Many mutual funds today use a so-called “multi-manager structure,” in which a fund’s primary investment adviser selects and oversees subadvisers who, in effect, serve as day-to-day portfolio managers for the fund. A mutual fund that uses this structure (multi-manager fund) may operate pursuant to a Commission exemptive order under the Investment Company Act that allows a subadviser to serve under a contract that has not been approved by the fund’s shareholders, subject to a set of protective conditions (multi-manager order). Since 1995, the Commission and the staff, under delegated authority, have issued over 200 multi-manager orders.<sup>1</sup> These orders enable funds to realize certain efficiencies while protecting the interests of their shareholders.<sup>2</sup>

Under the multi-manager orders, among other requirements, the aggregate fee rate payable by a fund for advisory services, both primary and subadvisory (aggregate advisory rate), remains subject to fund shareholder approval. The staff periodically receives interpretive questions about circumstances that may or may not trigger an increase in the aggregate advisory rate and necessitate shareholder approval. The staff is issuing this guidance to assist funds in complying with this aspect of the multi-manager orders.

***Background***

Section 15(a) of the Investment Company Act, in relevant part, makes it “unlawful for any person to serve or act as investment adviser of a registered investment company, except pursuant to a written contract, which contract, whether with such registered company or with an investment adviser of such registered company, has been approved by the vote of a majority of the outstanding voting securities of such registered company.” Section 15(a)(1) also requires the contract to “precisely describe[] all compensation to be paid thereunder.”

A multi-manager order grants relief from Section 15(a) to permit a subadviser to serve under a contract that has not been approved by the multi-manager fund’s shareholders. A multi-manager fund’s contract with its primary adviser (primary advisory contract), as well as the aggregate advisory rate, remain subject to shareholder approval.



Multi-manager orders generally contemplate two potential contractual scenarios (multi-manager models):

- The “traditional” multi-manager model—the fund enters into a contract with, and pays compensation for advisory services to, only the primary adviser. The primary adviser, in turn, enters into separate contracts with one or more subadvisers, and compensates the subadvisers out of the advisory fee it receives from the fund. The primary advisory contract specifies the rate that the fund agrees to pay for advisory services and must be approved by the fund’s shareholders under Section 15(a). Any increase in the specified rate (i.e., in the aggregate advisory rate), generally would constitute a material amendment to the primary advisory contract requiring shareholder approval under Section 15(a).
- The “direct-pay” multi-manager model—the fund enters into a contract with, and pays compensation to, each subadviser (subadvisory contract), in addition to entering into a contract with, and paying compensation to, the primary adviser. In this model, the rate specified in the primary advisory contract is not the aggregate advisory rate because it does not include the compensation that the fund has agreed to pay to the subadviser(s). Multi-manager orders that contemplate this model 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 (aggregate fee condition).

Under both multi-manager models, an increase in the aggregate advisory rate is subject to fund shareholder approval, by operation either of the primary advisory contract alone (in the “traditional” multi-manager model), or of the combination of the primary advisory contract and the aggregate fee condition (in the “direct-pay” multi-manager model).

#### ***Potential Applicants for Multi-Manager Orders***

To streamline applications for multi-manager orders and make explicit the existing requirements under both multi-manager models, the staff requests that all new applications include the aggregate fee condition, regardless of the multi-manager model that they plan to use.<sup>3</sup> The condition should specify that any new subadvisory contract or any amendment to any existing primary advisory contract or subadvisory contract that directly or indirectly results in an increase in the aggregate advisory rate charged to the fund will be submitted to the fund shareholders for their approval.

#### ***Existing Multi-Manager Orders***

The staff periodically receives interpretive questions about the aggregate fee condition. Typically, such questions arise in circumstances involving subadvisory contract changes. The staff is providing the following examples in the context of the “direct-pay” multi-manager model to assist funds and their counsel in complying with this aspect of their multi-manager orders:

- A fund's hiring of its first subadviser generally would require shareholder approval under the aggregate fee condition, unless the rate that the fund pays under its primary advisory contract will be reduced by the rate the fund will pay to the subadviser so that there is no increase in the aggregate advisory rate.
- Shareholder approval under the aggregate fee condition generally would not be required when a fund with one or more existing subadvisers hires an additional subadviser whose rate is no higher than: (i) in the case of the new subadviser replacing an existing subadviser, the rate of the subadviser being replaced; or (ii) the rate of another existing subadviser to which the adviser could have allocated the fund's assets that are being allocated to the new subadviser (e.g., assets in the same asset class).
- Shareholder approval under the aggregate fee condition also generally would not be required if any increase in the rate payable by a fund to an existing subadviser is accompanied by a corresponding decrease in the primary advisory contract of the rate payable by the fund to the primary adviser.

These examples are not exhaustive of the potential circumstances that might arise involving subadvisory contract changes and are provided only for general guidance purposes. The staff encourages applicants to contact the staff with any questions about the aggregate fee condition or any other aspect of the multi-manager orders.

### Endnotes

- 1 In 2003, the Commission proposed rule 15a-5 under the Investment Company Act to codify the exemptive relief granted in the multi-manager orders. See *Exemption from Shareholder Approval for Certain Subadvisory Contracts*, Rel. IC-26230 (Oct. 23, 2003) (Proposing Release).
- 2 In the Proposing Release, the Commission noted that:
 

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.

Proposing Release, at text accompanying note 9. See also *Nationwide Mutual Funds, et al.* (SEC Staff No-Action Letter, pub. avail. Apr. 5, 2011).
- 3 This approach is consistent with the Commission's proposed rule 15a-5.

This *IM Guidance Update* summarizes the views of the Division of Investment Management regarding various requirements of the federal securities laws. Future changes in laws or regulations may supersede some of the discussion or issues raised herein. This *IM Guidance Update* is not a rule, regulation or statement of the Commission, and the Commission has neither approved nor disapproved of this *IM Guidance Update*.

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