MFDF
Trusted Insight for Independent Oversight

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MFDF Report

Board Oversight of Advisory Agreement Approvals

Part 2: 15(c) Board Processes

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OVERVIEW

Directors[1] of registered investment companies (funds) have a wide range of responsibilities, but a board's decision to approve an investment advisory agreement is arguably one of the most fundamental. Statutory requirements and judicial caselaw provide a basic construct for the advisory agreement approval, commonly known as the "15(c)" process, but the practices of fund boards in executing their 15(c) responsibilities vary widely based on the size of the complex and the type of fund(s) covered, among other factors.

This MFDF 15(c) White Paper[2] is intended to serve as a reference regarding the advisory agreement renewal process and relevant enforcement actions, as well as a resource of possible approaches to 15(c) board processes and avenues directors may consider when analyzing complex or challenging facts and circumstances in their review.

MFDF's 15(c) White Paper will be issued successively in the following four parts:

Part 1: Regulatory Requirements and Judicial Caselaw
Part 2: Board Processes
Part 3: *Gartenberg* Factor Analysis and Board Considerations
Part 4: Enforcement Action Takeaways

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INTRODUCTION

While Section 15(c) of the Investment Company Act of 1940 (the "1940 Act") requires a designated annual "15(c) meeting" for independent directors[3] to vote to renew a fund's advisory agreement after its initial term of up to two years, it is important to note that the "15(c) process" usually occurs on an ongoing basis throughout the year. Directors receive information on a variety of matters, many of which may be related to their 15(c) responsibilities. Accordingly, the factors considered and the conclusions reached at the annual 15(c) review meeting will be based on information provided by the adviser and board discussions over the course of the year (perhaps even over several years) and will represent an overall assessment by the independent directors of the adviser's fees and services as part of their decision regarding annual renewal.

Independent directors have a fiduciary responsibility to protect the interests of fund shareholders, and their role in evaluating investment advisory agreements is one of their core board governance duties. Section 15 of the 1940 Act and relevant case law outline their responsibilities. In particular, the *Gartenberg* case and the many cases following *Gartenberg* provide guidance for independent directors in this area.[4] However, these statutory and judicial frameworks do not prescribe how independent directors should execute their responsibilities relating to advisory agreement approvals, and procedures vary widely across fund complexes. In considering the 15(c) process at their own complexes, boards should consider their particular funds.

Directors may find the following practical observations helpful. The 15(c) Review Considerations At-a-Glance section provides a reference to key takeaways that directors can refer back to in preparation for 15(c) meetings. The balance of this Part II provides additional detail regarding board 15(c) processes.

15(c) Review Considerations At-a-Glance

15(c) Questionnaire

The "15(c) questionnaire" generally serves as the basis of the 15(c) process. This formal, written request asks the adviser or sub-adviser for information relevant to the review and approval of the advisory contract. The 15(c) questionnaire generally contains information and material requests pertinent to each of the *Gartenberg* factors, as well as other information boards have found to be relevant[5]. In reviewing the 15(c) questionnaire, independent directors may consider the following:

- Providing input to 15(c) questionnaires or process[6];
- Adding new questions to reflect new areas of inquiry or regulatory developments; and
- Removing questions if some areas of inquiry are no longer relevant or are otherwise addressed in other materials or reports provided to the board.

Pre-Meetings and Review

The 15(c) process occurs throughout the year. Boards may find it helpful to develop a 15(c) calendar that sets a timetable for steps including document review, receipt of materials, board deliberations and submission to management of follow-up requests. Some independent directors have found the following approaches to review of 15(c) materials in advance of the designated 15(c) board meeting helpful:

- Holding pre-meetings or pre-calls with and/or without adviser representatives to facilitate discussion in advance of the 15(c) meeting;
- Reviewing 15(c) questionnaire responses in advance of the designated 15(c) meeting with counsel, as applicable;
- Assessing whether all independent director requests have been answered completely and requesting additional information when needed, as well as requesting whether the information should be provided verbally and/or in writing at the meeting;
- Involving the appropriate parties in the 15(c) process, such as the fund chief compliance officer, senior management of the adviser, fund counsel, and/or independent director counsel; and
- Incorporating enough time for advisers to provide complete responses and for independent directors to have sufficient time for comprehensive review.

Following each year's 15(c) review, boards may find it helpful to conduct a 'post-mortem' review to discuss how the process could be improved in the following year.

Vendors and Service Providers

Fund service providers and third-party vendors, such as independent providers of investment company data, can provide critical assistance in the 15(c) process. In their oversight of the entities relied upon in the 15(c) process, independent directors may wish to consider the following, as applicable:

- Whether the independent directors understand the methodology used to identify relevant peer groups and any limitations of the peer group data;
- Whether any changes to peer groups have been adequately explained, including who requested the change and the impact on the fund's comparative data;
- Periodically re-evaluating the vendors utilized to prepare 15(c) report and data;
- Inquiring about the level of data and resources available on an annual or other periodic basis; and
- Engaging unaffiliated third-party consultants, counsel or outside vendors to provide expert opinions or analysis, respond to inquiries or offer alternative or independent points of view on discrete matters (for example, with respect to complex investment strategies or new vendor reporting in response to emerging regulatory requirements).

Board Processes to Enhance Efficiencies and Effectiveness

Adopting a 'divide and conquer' approach to the initial 15(c) review can help to promote an effective and efficient process. Some boards may find that the following approaches can help allocate initial review responsibilities:

- Leveraging committees, such as contract or 15(c) committees, or less formal teams/working groups to conduct initial 15(c) reviews;
- Allocating 15(c) responsibilities, such as conducting an initial review of the 15(c) questionnaire and the annual *Gartenberg* memo, reviewing and proposing amendments to the 15(c) process, and evaluating 15(c) reports to designated committees;
- Assessing whether to modify committee charters to address any 15(c) responsibilities; and
- Dividing funds or groups of advisers or sub-advisers among independent directors for the purpose of leading reviews or discussions.

Boards generally review an enormous volume of material in connection with their 15(c) review process, and independent directors may find that the following approaches allow them to analyze materials more efficiently:

- Adopting the same 15(c) questionnaire across a fund complex;
- Using consistent investment performance results, fee/expense, brokerage and portfolio management reporting formats;
- Using dashboard or 'exception' reporting, dividing funds and/or advisers for different levels of review based on risk, and/or adopting 'watch lists' that flag issues for further review;
- Leveraging fund complex resources such as legal and compliance teams when available;
- Working with the adviser to give the board necessary information in a form that is reasonable for the adviser to produce; and
- In a 'manager of managers' fund complex, requesting that the adviser provide an assessment of its review of the sub-adviser's 15(c) questionnaire responses.

Compliance Policies and Procedures

Section 15(c) compliance policies are not required by Section 15(c) of the 1940 Act, but boards overseeing funds that do elect to have such policies may find it helpful to consider the following:

- Adopting high-level, broad and/or philosophical policies, rather than those that are prescriptive, to allow greater flexibility to adapt to changing circumstances;
- Addressing key responsibilities in the 15(c) process and/or designating key parties for execution of those responsibilities;
- Developing a 15(c) calendar; and
- Formalizing processes through which material updates to 15(c) roles, responsibilities, timing or requested information is communicated to all responsible parties, including the full board.

Board Meeting Minutes

Independent directors may wish to consider the following with respect to minutes of meetings relating to 15(c) reviews and approvals:

- Noting that minutes represent the primary record for the board discussion of advisory agreement approvals and the basis for N-CSR disclosure;
- Evidencing the robust analysis of the directors in their 15(c) review and working with counsel if available to determine the appropriate level of detail;

- Avoiding boilerplate language;
- Addressing each *Gartenberg* factor; and
- Reviewing minutes carefully in advance of their approval to avoid material misstatements, omissions or untrue statements.

15(c) Review Considerations for Directors

15(c) QUESTIONNAIRE

The process for the annual 15(c) review can vary widely based on the complexity of the fund, the size of the fund complex, and other factors. The 15(c) meeting process often begins with the "15(c) questionnaire," which is a formal, written request from or on behalf of the board for information from any adviser or sub-adviser with an advisory agreement subject to review and approval at the annual 15(c) meeting. Counsel often assists the board in the preparation of the 15(c) questionnaire, which is designed to help satisfy the requirement of Section 15(c) of the 1940 Act that requires the board to request and evaluate, and the adviser or sub-adviser to provide, information reasonably necessary to evaluate the terms of the fund's advisory agreement. The 15(c) questionnaire generally contains information and material requests pertinent to each of the *Gartenberg* factors, as well as other information directors have found to be relevant.

While boards may request information relating to any factor that the board considers appropriate, boards generally find that the *Gartenberg* factors are sufficiently broad to cover most information necessary for the evaluation of any fund's advisory agreement. Counsel generally also provides a memo summarizing the board's legal obligations, relevant case law, and key factors to consider as the independent directors evaluate the approval or renewal of each advisory agreement. For series trusts or funds with one or more sub-advisers, each adviser or sub-adviser usually completes its own 15(c) questionnaire, although in some cases boards may wish to add certain questions to the adviser's questionnaire relating to its oversight role.

Directors are often involved in the review and modification of the 15(c) questionnaire from year to year, although counsel typically has primary responsibility for updating it on an annual basis. In some cases, after discussion about potential areas of inquiry, directors may elect to receive an updated 15(c) questionnaire, marked to show proposed changes from the prior year, and then have the opportunity to comment on the updated questionnaire. In addition to adding new areas for inquiry, questions may be reviewed to determine whether they continue to be relevant over time (such as with respect to questions regarding COVID protocols). The 15(c) questionnaires may be modified each year to address any new areas in which the directors may be interested or remove questions that are no longer relevant. In addition, changes might

be made to clarify the wording of certain questions, address changes in applicable laws, address regulatory or enforcement matters or priorities, or request information relating to rapid, unexpected or significant changes or other market conditions or other recent developments relating to the fund or adviser. To the extent that material edits have been made to the 15(c) questionnaire, the board may request to receive an updated draft of the questionnaire prior to its distribution to advisers.

A draft 15(c) questionnaire may be submitted to the adviser in advance to give the adviser an opportunity to seek clarification of questions or any potential ambiguities before the final 15(c) questionnaire is delivered. The content of the 15(c) questionnaire may be tailored to address the particular advisory agreement under review. For example, if an adviser provides investment advice to non-fund clients for similar strategies, the request will likely include information concerning the fees charged and services provided to those other accounts, and if an adviser serves as a sub-adviser to other funds, the request may include fees earned by the adviser as sub-adviser for similar strategies. The questionnaire usually requests information regarding the services that the investment adviser has agreed to provide. The 15(c) questionnaire should include appropriate questions about any services other than investment advice included under the advisory agreement. Traditionally, other services may include items such as administrative, fund accounting or even compliance services. 15(c) questionnaires generally evolve over time as facts and circumstances change regarding services, fees, service provider relationships, and/or other relevant factors.

The 15(c) process may pose unique considerations for series trusts and multi-manager fund complexes. For example, using a standardized questionnaire and information gathering process can aid the independent directors' efficient consideration of multiple renewals for multiple advisers and sub-advisers over the course of the year. If a fund complex has a number of sub-advisers, boards may seek to request additional information or clarifying responses if answers from different sub-advisers conflict. For series trusts or funds with one or more sub-advisers, each adviser or sub-adviser usually completes its own 15(c) questionnaire. In evaluating sub-advisory agreements, independent directors may give significant weight to the primary adviser's oversight of the sub-adviser consistent with the primary adviser's role to select and monitor the sub-adviser. In a multi-manager fund complex, boards may wish to consider whether certain questions related to the sub-adviser should be added or moved to the primary adviser's questionnaire as part of the adviser's oversight of the sub-adviser. Each adviser and sub-adviser should clearly understand the information that the board is seeking.

15(c) RESPONSE PRE-MEETINGS AND REVIEW

After any updates have been incorporated, the formal 15(c) questionnaire is then distributed to each adviser and sub-adviser with ample time provided for each response. The advisers provide a written response to each question, and the completed questionnaire and supporting information is then distributed to the board for review. Boards may hold a single or series of meetings to analyze the information prior to a final vote. In many cases, representatives of the adviser may be asked to review the information for each fund with the board, either at the 15(c) meeting or during a pre-meeting. Pre-meetings may be held which provide an opportunity for open discussion between directors and adviser representatives in private sessions. Directors may also convene pre-meetings or pre-calls without the adviser representatives present to discuss any specific issues or areas of interest among the directors in order to assist in the preparation for the 15(c) meeting. In some cases, the advisory agreement, as well as the 15(c) responses provided for the 15(c) meeting and over time, may be reviewed and voted upon during the single designated 15(c) meeting. In other cases, materials may be reviewed in one meeting while the formal vote regarding the approval of the advisory agreement may occur during a separate meeting.

After reviewing the written materials provided, independent directors may pose follow-up questions or requests to be addressed before the final vote is taken. Providing a reasonable amount of time for the adviser to respond to supplemental information requests is critical in order to obtain accurate and complete responses. Independent directors may request that advisers either provide supplemental information in written form prior to the 15(c) board meeting or be prepared to discuss their responses at the 15(c) board meeting. In-person responses may be appropriate, especially in circumstances in which the adviser has sensitivity about the extent of the audience for written materials. For example, the adviser may wish to restrict access to the adviser's financial statements only to the board. Oral discussions may also be appropriate when there is a late business development that may be material to the approval of the advisory agreement, such as a proposed proxy, investment strategy change recommendation or material portfolio management change.

With respect to the review of the 15(c) responses, there is no standard across boards, but it may be helpful to understand who, in addition to the board, might assist the board, including the fund CCO, fund counsel and/or independent director counsel. Completed 15(c) materials should be read carefully, and there should be follow-up for any incomplete or unclear responses. In most cases, corrected or additional information is requested and provided in writing or during a meeting so that the independent directors have the information they have determined is reasonably necessary in their evaluation of an advisory agreement. If any

requested information is unavailable or determined to no longer be necessary, the facts and circumstances can be discussed with the board and documented appropriately. In some cases, the advisory agreement, as well as the 15(c) responses provided for the 15(c) meeting and over time, may be reviewed and voted upon during the single designated 15(c) meeting. In other cases, materials may be reviewed in one meeting while the formal vote regarding the approval of the advisory agreement may occur during a separate meeting.

15(c) VENDORS AND FUND SERVICE PROVIDERS

Third party vendors can serve a critical role in aiding independent directors in their review of 15(c) materials. For example, boards may utilize third party vendors to help identify relevant peer groups as well as to provide independent fee and performance benchmarking data. These vendors offer both broad industry experience as well as an independent lens for relevant fund data. The identification of a relevant peer group to compare performance and expenses for each fund is important. Boards may inquire about the methodology used by the vendor to select the peer groups. In addition, if there were any changes to the methodology or peer group selected, the board may inquire about why those changes were made, who requested the changes and the impact on the comparisons (i.e., does the fund's performance compare more or less favorably, and is the adviser's fee comparatively higher or lower). Boards may elect to re-evaluate the vendors utilized to prepare 15(c) reports and data on a periodic basis. There may be a wide range of levels of data available to boards, and boards may seek to periodically evaluate what resources are available to them from management or third-party vendors.

Fund boards may also hire unaffiliated third-party consultants, counsel or outside vendors to provide expert opinions, respond to board inquiries or offer an alternative point of view on topics such as investment models, profitability methodologies, comparing services or performance, operational issues, cybersecurity protocols, or the 15(c) process itself, among other areas. In some circumstances, consultants may be utilized in the development and review of the 15(c) questionnaire itself. Boards may also elect to engage consultants to provide 15(c) training classes on the 15(c) process and industry developments.

USE OF BOARD COMMITTEES AND PROCESSES TO ALLOCATE INITIAL REVIEW RESPONSIBILITIES

Boards may elect to use committees, with varying levels of formality, to help with the 15(c) review process. For example, some boards may utilize contract committees, which focus on matters pertaining to fund agreements broadly, and others may utilize 15(c) committees, which are focused more specifically on the advisory agreement renewal process. Such committees

may include all of the independent directors or a subset. These committees can be beneficial in order to divide initial review responsibilities or create a subset of independent directors. Board committees could be responsible for a preliminary review of counsel's *Gartenberg* memo, review and editing of the 15(c) questionnaire, the overall 15(c) process, and/or the evaluation of reports with information relevant to the assessment of each fund's advisory agreement, which may be amongst other committee duties. While boards generally adopt a charter outlining a committee's responsibilities, such charters may opt to describe the 15(c) processes undertaken by a committee at a high level rather than in a granular fashion.

Some boards may also opt to divide preliminary individual fund review responsibilities across types of funds (equity or fixed income, for example) in a 'divide and conquer' approach. Other boards might elect to divide preliminary review by groups of advisers or sub-advisers. In these circumstances, independent directors assigned to specific fund or adviser categories might be tasked with leading the discussions regarding their segment of the 15(c) review with the other independent directors, voicing observations or identifying areas of focus or follow-up questions or requests.

ENHANCING EFFECTIVENESS IN THE 15(c) PROCESS

Capturing efficiencies in the 15(c) process can facilitate board review of advisory agreements, and boards have adopted various ways to do so. The adoption of common 15(c) questionnaires across a complex, the use of consistent investment performance results, fees and expenses, brokerage and portfolio management reporting mechanisms, and the use of "dashboards" or exception reporting are all options to consider in order to achieve a more efficient 15(c) review process. Dashboards may be utilized to aggregate, summarize and highlight key data and contain summaries of certain manager responses. Exception reporting can, based on pre-determined criteria, help highlight funds that independent directors may believe require additional scrutiny. Large complexes may also benefit from certain potential economies of scale and increased resources that can facilitate the review process, such as access to robust compliance and legal teams. Boards may wish to consider whether it is possible to produce information in light of resource or other constraints, and information requests can be tailored to information the independent directors needs for their review.

In addition, boards may divide funds and/or advisers into risk levels (e.g., red, yellow or green) to determine which funds may require greater inquiry by the independent directors. When analyzing the nature and quality of services being provided, poor total return investment performance is often a factor cited in identifying funds for heightened review. Also, material compliance violations, advisory firm issues that could materially impact the services provided

to a fund, merger and acquisition activity, advisory firm senior personnel changes or departures or portfolio manager departures/succession planning could also be deemed factors for heightened review. Boards may opt to use "watch lists" that could flag issues for further review and regular attention at subsequent board meetings until any identified issues are resolved and the subject funds are removed from the watch list. Watch lists may be formalized and operate pursuant to relevant compliance policies and procedures, or boards may elect to adopt a more informal means to monitor funds subject to heightened review.

15(c) COMPLIANCE POLICIES AND PROCEDURES

While not specifically required by Section 15(c), funds may elect to adopt 15(c) policies and procedures as part of their 38a-1 fund compliance manual. Although the 15(c) process itself is only prescribed to a limited degree under the 1940 Act, the SEC staff has recently taken a keen interest in assessing industry approaches to managing the 15(c) process, e.g., directors' diligence, care, thoroughness, independence, etc. In 2023, the SEC staff focused its examinations on how fund advisers respond to their board's 15(c) inquiries.[7] In addition, the SEC's November 2024 Risk Alert highlighted the fund investment advisory agreement approval process and the thoroughness of the board's review of fund fees for consistency with disclosures (e.g. whether fund boards compared the services to be rendered and amounts to be paid under the contract to those under other advisory contracts with the adviser or other fund advisers, such as peer groups, or other types of clients). In light of document requests made during recent exams, funds may want to consider if they want to adopt formal policies and procedures governing the 15(c) process. To provide appropriate flexibility to adapt to changing circumstances, funds may wish to consider adopting high-level, broad, and/or more philosophical, rather than prescriptive, 15(c) policies and procedures. Such policies could address the timing of key receivables from management and delivery of the 15(c) questionnaire and timing of meeting dates, etc. Funds may wish to avoid adopting 15(c) policies that are too granular in order to avoid inadvertent compliance violations related to actions not material to the overall 15(c) process. To the extent that there are material updates to roles or responsibilities in the 15(c) review process, timing and requested information, funds may elect to formalize procedures whereby modifications are communicated to all responsible parties, including the full board.

DOCUMENTATION OF 15(c) REVIEW IN BOARD MEETING MINUTES

The documentation of the 15(c) review in the 15(c) board meeting minutes serves as a key primary record of each advisory and sub-advisory agreement review, discussion, and approval

and also serves as a key supporting record for related disclosure. A goal in drafting minutes in this context is to evidence the robust discussion of the advisory and sub-advisory agreement deliberations of the independent directors, often with the assistance of counsel to determine the level of detail to be included in the minutes necessary to support the independent directors' conclusions. Any teleconferences or meetings among the independent directors to review the 15(c) materials prior to the 15(c) board meeting would generally be identified in the 15(c) board meeting minutes to memorialize such meetings in the 15(c) record. Board meeting minutes and board considerations disclosure filed with the SEC should not be boilerplate. Board meeting minutes or the board considerations disclosure should generally also address each relevant *Gartenberg* factor with respect to each advisory and sub-advisory agreement under consideration and its potential applicability to each fund. Directors should review minutes carefully in advance of their approval at subsequent board meetings to avoid material misstatements, omissions or untrue statements regarding the 15(c) process.

CONCLUSION

Consideration of the approval and renewal of fund advisory agreements is a fundamental responsibility of independent directors, but the 1940 Act does not precisely specify how this process should be executed. Pursuant to Section 15(c) of the 1940 Act, boards are responsible for requesting and evaluating, and advisers are responsible for providing, the information reasonably necessary to evaluate the terms of an advisory agreement. In order to limit the influence of interested directors, a majority of the independent directors must approve each advisory agreement initially and upon its renewal. Independent directors should consider how to develop a process that adequately addresses all material information and key areas relevant for their advisory agreement analysis and review. Approaches to the 15(c) process may justifiably vary considerably based on fund complexity, size and other factors. In addition, independent directors should be mindful to allocate sufficient time for a diligent, conscientious, and robust review process in order to prudently execute their responsibilities relating to 15(c) advisory agreement approvals. Directors may seek to allocate dedicated time during board meetings to discuss the 15(c) process with counsel, or attend educational sessions that capture regulatory and industry updates relating to the advisory agreement renewal process and provide the opportunity for directors of differing fund complexes to share best practices.

In general, it is extremely important to keep in mind that the 15(c) process is generally an "iterative process" over time. This process serves to provide a disciplined and rigorous review of material and relevant information regarding an adviser's operations and its acumen in managing funds for which it has contractual arrangements. In this way, independent directors

can execute an effective 15(c) process which in good faith they believe will effectively fulfill their statutory duty in considering the various advisory agreements subject to their review.

ENDNOTES

[1] For ease of reference, 'Director' will be 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.

[2] 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 1035 independent directors, representing 149 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.

[3] Independent director means a director who is not an "interested person" within the meaning of Section 2(a)(19) of the 1940 Act. This means that independent directors are not permitted to own stock of a fund's investment adviser or certain affiliates, and are not permitted to have had a significant business relationship with the fund's adviser, distributor, or their affiliates at any time during the prior two years.

[4] *Gartenberg v. Merrill Lynch Asset Management, Inc.*, 694 F.2d 923 (2d Cir. 1982). The *Gartenberg* factors established by the court for boards to review in connection with their review of registered fund investment advisory agreements are: 1. The nature and quality of services provided to fund shareholders; 2. The profitability of the fund to the adviser; 3. Fall-out benefits 4. Economies of scale; 5. Comparative fee structures; and 6. The independence and conscientiousness of the directors. The *Gartenberg* factors are discussed in further detail in each of the other sections of this white paper.

[5] Some boards that have independent director counsel may find them to be a helpful resource for guidance regarding other factors that may be relevant for the board's consideration.

[6] Note that not all boards review the 15(c) questionnaire annually in advance. Many boards rely on counsel to update the questionnaire, and boards may provide input during the process about supplemental requests or requests for the following year.

[7] *See* Press Release, *SEC Division of Examinations Announces 2023 Priorities, Securities and Exchange Commission* (Feb. 7, 2023), available at https://www.sec.gov/newsroom/press-releases/2023-24.