SEC EXTENDS MULTI-MANAGER EXEMPTIVE RELIEF TO PARTIALLY-OWNED SUBADVISERS

Date: 29 May 2019

Investment Management Alert

By: Clifford J. Alexander, Kathy Kresch Ingber

I. INTRODUCTION

On May 29, 2019, the U.S. Securities and Exchange Commission (the "SEC") issued an order (the "New Order") expanding the scope of exemptive relief available to multi-manager funds. The New Order is the first exemptive order issued by the SEC to extend multi-manager relief to all subadvisers, whether unaffiliated with, wholly-owned by or partially-owned by an investment adviser.

The New Order permits Carillon Series Trust, a registered investment company (the "Trust"), and its investment adviser, Carillon Tower Advisers, Inc. (the "Adviser"), a subsidiary of Raymond James Financial, Inc., to enter into new or modified subadvisory agreements with any existing or new subadviser, without the approval of fund shareholders, regardless of the level of the subadviser's affiliation with the Adviser.[1] The New Order supersedes a previous order (the "Prior Order") granting substantially similar exemptive relief to the Trust and the Adviser solely with respect to subadvisers that either are wholly-owned by the Adviser or have no affiliation with the Adviser.[2] Mutual fund complexes typically operate in so-called "multi-manager" or "manager of manager" structures pursuant to exemptive orders that grant the same relief as the Prior Order.

Consolidation in the investment management industry has been marked by the acquisition by larger advisory firms of majority or minority ownership interests in smaller firms. The acquisition of a partial ownership interest allows a larger firm to expand its product offerings and increase its profit margin, and the smaller firm to retain a level of independence and a continued interest in the success of the firm.

The New Order is a critically important and welcome development, bringing the regulatory framework governing mutual funds that operate in a multi-manager structure in line with industry merger and acquisition trends. Advisory firms that are partially-owned by a fund's investment adviser have fallen outside the purview of previous multi-manager orders, which apply solely to wholly-owned and unaffiliated subadvisers. The New Order extends the scope of multi-manager relief to partially-owned subadvisers. Moreover, the relief furthers the historical purpose of multi-manager orders, which is to permit a fund complex to operate in an efficient and cost-effective manner.

II. BACKGROUND

A. Section 15(a) of the 1940 Act

Section 15(a) of the Investment Company Act of 1940, as amended (the "1940 Act"), requires that an investment advisory contract be approved by the vote of a majority of a fund's outstanding voting securities and a majority of

©2005-2026 K&L Gates LLP. All Rights Reserved.

the fund's board of directors, including a majority of the directors who are not parties to the contract or interested persons of any such party. Section 15(a) also provides for an advisory contract to continue in effect for a period more than two years from the date of its execution only so long as such continuance is specifically approved at least annually by the fund's board of directors or by vote of a majority of the outstanding voting securities. Significantly, subadvisers fall within the 1940 Act definition of “investment adviser” and Section 15 does not distinguish between contracts with investment advisers and subadvisers.

The SEC staff takes the position that a material change to an advisory contract creates a new contract and, therefore, requires shareholder approval under Section 15(a).[3] Further, Section 15(a)(4) requires an advisory contract to provide, in substance, that it will terminate automatically in the event of its “assignment,” which is deemed to result from a change in control of a fund's investment adviser or subadviser.[4] If an advisory contract automatically terminates due to an assignment, a fund must enter into a new contract with the investment adviser and obtain board and shareholder approval.

B. Emergence of Multi-Manager Exemptive Relief

When an investment adviser provides services directly to a mutual fund, the investment adviser employs one or more portfolio managers to make day-to-day investment decisions for the fund. The investment adviser may terminate and hire portfolio managers without board or shareholder approval and has sole discretion to set the portfolio managers' compensation. Alternatively, a significant number of investment advisers hire subadvisers to make day-to-day investment decisions for all or a portion of a funds' assets. In both cases, primary responsibility for the management of fund assets remains vested in the investment adviser, subject to the oversight of the fund's board of directors.

However, the similarities end there. While portfolio managers may be hired or replaced without shareholder approval, entering into or materially modifying a subadvisory agreement triggers the shareholder approval requirements of the 1940 Act discussed above. After a fund begins investment operations, the fund can obtain shareholder approval of an advisory contract only by filing a proxy statement with the SEC, mailing that proxy statement to shareholders and soliciting the required number of votes. This process often is costly and time-intensive, and therefore may inhibit the ability of investment advisers to manage subadvised funds efficiently and act in the best interests of the funds' shareholders.

Recognizing the increased use of subadvisers and the need for investment advisers to promptly hire or replace those subadvisers, the SEC first began to grant multi-manager exemptive relief in 1995.[5] The initial exemptive relief applied only to Non-Affiliated[6] subadvisers, and was extended to Wholly-Owned[7] subadvisers in 2000.[8] The New Order is the first instance of the SEC expanding multi-manager relief to all subadvisers, including Non-Affiliated subadvisers, Wholly-Owned subadvisers and Affiliated subadvisers that are partially-owned by an investment adviser.

III. THE NEW ORDER

The Prior Order applied only to Wholly-Owned and Non-Affiliated subadvisers and was subject to certain conditions. The applicants initially requested the New Order in 2013.[9] However, until now, the SEC has declined to recommend extending multi-manager exemptive relief to Affiliated subadvisers (other than Wholly-Owned subadvisers); an anomalous result, requiring funds seeking to hire partially-owned subadvisers to obtain shareholder approval in order to enter into such arrangements.[10]

©2005-2026 K&L Gates LLP. All Rights Reserved.

A. Shareholder Approval

The New Order permits the applicants to enter into and materially amend any subadvisory agreement without the shareholder approval required by Section 15(a) of the 1940 Act. The relief from the shareholder approval requirement also extends to the replacement or reinstatement of any subadviser when a subadvisory agreement has automatically terminated due to an "assignment" within the meaning of Section 2(a)(4) of the 1940 Act.

The applicants made the case that the New Order was warranted because (1) each subadviser was effectively acting as a portfolio manager to the relevant series of the Trust (each, a "Fund" and collectively, the "Funds"), (2) any economic incentive or conflict of interest with respect to an investment adviser's selection of a subadviser would be mitigated by the conditions set forth in the New Order and (3) Fund shareholders would benefit from greater efficiencies and reduced costs.[11] The applicants also noted that the Adviser performs substantially identical oversight of all subadvisers, regardless of the subadviser's affiliation with the Adviser, and that that the Adviser's oversight of subadvisers is similar in many respects to how the Adviser would oversee its own internal portfolio management team.

With respect to any potential economic incentive or conflict of interest that may arise when the Adviser recommends an Affiliated subadviser, the applicants further pointed out that (1) the Adviser faces those conflicts and incentives in allocating Fund assets between itself and any subadviser, including Affiliated subadvisers, (2) the Adviser employs the same methodology to evaluate potential conflict of interest, regardless of any affiliation between the Adviser and subadviser, and (3) the interests of Fund shareholders are protected by the conditions set forth in the New Order, which are described below in Sections II.C. and II.D. In addition, the applicants noted that shareholders would continue to be notified of a subadviser change or a material amendment to a subadvisory agreement, as provided in the conditions to the New Order and the applicants' application for multi-manager exemptive relief.

B. Aggregate Fee Disclosure

Under the New Order, each Fund is permitted to disclose in its registration statement the aggregate fees paid to (1) the Adviser and any Wholly-Owned subadviser and (2) any Affiliated and Non-Affiliated subadvisers, rather than the fees paid to the Adviser and each subadviser individually, as would otherwise be required by certain provisions of Form N-1A, Schedule 14A and Regulation S-X.

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

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

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

Prior Order	New Order

©2005-2026 K&L Gates LLP. All Rights Reserved.

The operation of the subadvised fund that is relying on the exemptive relief has been or will be approved by a majority of that fund's shareholders.	*Substantially Similar.*
The prospectus describes the fund's multi-manager structure, the investment adviser's responsibility to oversee the subadvisers and the relief granted by the SEC's exemptive order.	*Substantially Similar.*
The investment adviser provides general management services to each subadvised fund, including supervisory responsibilities of each subadviser's investment decisions and performance.	*Substantially Similar.*
A subadvised fund must not make any subadviser changes or material amendments to existing subadvisory agreements with subadvisers that are not covered by the exemptive relief, unless approved by shareholders pursuant to Section 15.	***Eliminated.***
A subadvised fund must inform shareholders of the hiring of a new subadviser covered by the exemptive relief within 90 days through an information statement.	*Substantially Similar.*
A subadvised must, at all times, have a board of trustees where a majority of such trustees are not "interested persons" of the applicable trust or investment adviser, as defined in Section 2(a)(19) of the 1940 Act (the "Independent Trustees"), and the nomination of new Independent Trustees will be placed in the discretion of the existing Independent Trustees.	*Substantially Similar.*
Independent legal counsel must be retained to represent the Independent Trustees.	*Substantially Similar.*
The investment adviser must provide, no less than quarterly, the board of trustees with information about the profitability of the investment adviser on a per subadvised fund basis.	***Eliminated.***
Whenever a subadviser is hired or terminated, the investment adviser must provide the board of trustees	*Substantially Similar.*

©2005-2026 K&L Gates LLP. All Rights Reserved.

with the expected impact of profitability on the investment adviser.	
When a subadviser change is proposed for a subadviser covered by the exemptive relief, the board of trustees must make a separate finding that (a) the change is in the best interests of the subadvised fund and its shareholders, and (b) the change does not involve a conflict of interest from which the investment adviser or applicable subadviser derives an inappropriate advantage.	***Expanded, as set forth below:*** The board of trustees must evaluate any material conflicts that may be present in a subadvisory arrangement. Specifically, whenever a subadviser change ("Subadviser Change") is proposed for a subadvised fund or the board of trustees considers an existing subadvisory agreement as part of its annual review process ("Subadviser Review"): the investment adviser will provide the board of trustees, to the extent not already being provided pursuant to Section 15(c) of the 1940 Act, with all relevant information concerning: any material interest in the proposed new subadviser, in the case of a Subadviser Change, or the subadviser in the case of a Subadviser Review, held directly or indirectly by the investment adviser or a parent or sister company of the investment adviser, and any material impact the proposed subadvisory agreement may have on that interest; any arrangement or understanding in which the investment adviser or any parent or sister company of the investment adviser is a participant that (A) may have had a material effect on the proposed Subadviser Change or Subadviser Review, or (B) may be materially affected by the proposed Subadviser Change or Subadviser Review; any material interest in a subadviser held directly or indirectly by an officer or trustee of the subadvised fund, or an officer or board member of the investment adviser (other than through a pooled investment vehicle not controlled by such person); and any other information that may be relevant to the

©2005-2026 K&L Gates LLP. All Rights Reserved.

	board of trustees in evaluating any potential material conflicts of interest in the proposed Subadviser Change or Subadviser Review. the board of trustees, including a majority of the Independent Trustees, will make a separate finding, reflected in the board of trustees minutes, that the Subadviser Change or continuation after Subadviser Review is in the best interests of the subadvised fund and its shareholders and, based on the information provided to the board of trustees, does not involve a conflict of interest from which the investment adviser, a subadviser, any officer or trustee of the subadvised fund, or any officer or board member of the investment adviser derives an inappropriate advantage.
No trustee or officer of a subadvised fund, or director or officer of the investment adviser, may own directly or indirectly (other than through a pooled investment vehicle that is not controlled by such person), any interest in a subadviser, except for (a) ownership of interests in the investment adviser or any entity, other than a Wholly-Owned subadviser, that controls, is controlled by, or is under common control with the investment adviser, or (b) ownership of less than 1% of the outstanding securities of any class of equity or debt of a publicly traded company that is either a subadviser or an entity that controls, is controlled by, or is under common control with a subadviser.	***Eliminated.***
Each subadvised fund must disclose the aggregate fee disclosures in its registration statement.	*Substantially Similar.*
The requested exemptive order will expire in the event the SEC adopts a rule providing substantially similar relief.	*Substantially Similar.*
Any new or amended advisory agreement that directly or indirectly results in an increase in the aggregate advisory fee rate payable by the applicable subadvised fund must be submitted to that fund's shareholders for approval.	*Substantially Similar.*

©2005-2026 K&L Gates LLP. All Rights Reserved.

D. The Conditions: Notable Differences

As noted in the table above, the conditions for reliance on the New Order are similar to the conditions in the Prior Order, with a few notable differences, as described below:

- Because the New Order extends to any subadviser, shareholder approval for a subadviser change with respect to a partially-owned subadviser is not required;
- The Adviser is no longer required to provide quarterly profitability information of the Adviser on a per subadvised Fund basis. However, the Trust's board of trustees ("Board") must continue to review profitability information at the time of any proposed subadviser change and as part of its annual review of each subadvisory agreement pursuant to Section 15(c) of the 1940 Act;
- Trustee and officer ownership of an interest in a subadviser is no longer prohibited. The applicants made the case that restricting ownership of interests in a subadviser by trustees and officers would not be meaningful where the investment adviser may itself own an interest in the subadviser; and
- The findings that must be made by the Board are expanded to require that the Board evaluate potential material conflicts of interest when a subadviser change is proposed for a subadvised Fund or when the Board considers an existing subadvisory agreement as part of its annual review process. Specifically, the Adviser is required to provide the Board with certain information related to material conflicts of interest each year during the annual review process, including (1) any material interest the Adviser has in the subadviser and any material impact the subadvisory agreement may have on that interest, (2) any arrangement or understanding in which the Adviser is a participant that may materially affect, or be materially affected by, the subadvisory agreement, and (3) any other information that may be relevant to the Board in evaluating potential material conflicts of interest with respect to the subadvisory agreement.

IV. TAKEAWAYS

The extension of multi-manager relief to partially-owned subadvisers is a natural and logical step that will expand the scope of advisory firms that can be hired in a multi-manager structure without shareholder approval. The New Order is particularly timely in light of the recent spate of mergers and acquisitions in the investment management industry. As such, the New Order eliminates one regulatory hurdle that managers consider in connection with a partial acquisition of another firm that will serve as a subadviser to a registered investment company.

As the New Order is the first of its kind, it was considered and approved directly by the SEC Commissioners. The Commissioners also allow the SEC staff to issue future orders by delegated authority that mirror the New Order, and it is our understanding that the staff intends to do so. Interestingly, the issuance of the New Order coincides with the SEC's consideration of an exemptive application that seeks relief to ease other requirements related to the operation of a multi-manager structure. In particular, Blackstone Alternative Investment Funds and its investment adviser, Blackstone Alternative Investment Advisors LLC, recently filed an application for exemptive relief that would allow the board of trustees of a fund complex that operates in a multi-manager structure to approve or materially amend a subadvisory contract without an in-person meeting, subject to certain conditions. The applicants emphasized that the elimination of the in-person meeting requirement set forth in Section 15(c) of the 1940 Act would further align the treatment of the subadvisers of multi-managed funds with that of portfolio

©2005-2026 K&L Gates LLP. All Rights Reserved.

managers and promote the more efficient operation of the funds.[12] Together the New Order and the pending application reflect the willingness of the current SEC Commissioners to regulate mutual funds in a manner designed to more effectively promote their efficient operation while providing the requisite investor protections.

Notes:

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

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

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

[4] Section 2(a)(4) of the 1940 Act defines "assignment" to include "any direct or indirect transfer or hypothecation of a contract or chose in action by the assignor, or of a controlling block of the assignor's outstanding voting securities by a security holder of the assignor. . . ." Although the term "controlling block" of voting securities is not defined under the 1940 Act, Section 2(a)(9) of the 1940 Act defines "control" as "the power to exercise a controlling influence over the management or policies of a company, unless such power is solely the result of an official position with such company." In addition, Section 2(a)(9) of the 1940 Act provides a rebuttable presumption of control when any person beneficially owns, either directly or indirectly, more than 25 percent of the voting securities of a company. A person who does not own more than 25 percent of the voting securities of a company is presumed not to control the company.

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

[6] A "Non-Affiliated" subadviser is defined as: a subadviser that is not an affiliated person (as defined in Section 2(a)(3) of the 1940 Act) of the relevant fund or the investment adviser (other than by reason of serving as a subadviser to one or more of the funds advised by the investment adviser).

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

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

[7] A "Wholly-Owned" subadviser is defined as: (1) an indirect or direct "wholly-owned subsidiary" (as such term is defined in the 1940 Act) of the investment adviser, or (2) a sister company of the investment adviser that is an

©2005-2026 K&L Gates LLP. All Rights Reserved.

indirect or direct “wholly-owned subsidiary” of the same company that, indirectly or directly, wholly owns the investment adviser.

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

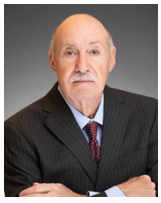
[9] Prior Order, *supra* note 2.

[10] An “Affiliated” subadviser is defined as: an affiliated person (as defined in Section 2(a)(3) of the 1940 Act) of the subadvised fund or of the investment adviser, other than by reason of serving as a subadviser to one or more of the applicable subadvised funds.

[11] *See* “Fourth Amendment to the Application for an Order of Exemption Pursuant to Section 6(c) of the Investment Company Act of 1940, as Amended (the '1940 Act'), from: (1) Certain Provisions of Section 15(a) of the 1940 Act, and (2) Certain Disclosure Requirements under Various Rules and Forms” (Mar. 26, 2019).

[12] *See* “Amended and Restated Application Pursuant to Section 6(c) of the Investment Company Act of 1940, As Amended, for an Order of Exemption from Section 15(c) of the Act” (Mar. 29, 2019).

KEY CONTACTS



CLIFFORD J. ALEXANDER
SENIOR OF COUNSEL

WASHINGTON, DC
+1.202.778.9068
CLIFFORD.ALEXANDER@KLGATES.COM



KATHY KRESCH INGBER
PARTNER

WASHINGTON, DC
+1.202.778.9015
KATHY.INGBER@KLGATES.COM

This publication/newsletter is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer. Any views expressed herein are those of the author(s) and not necessarily those of the law firm's clients.

©2005-2026 K&L Gates LLP. All Rights Reserved.