The Investment Lawyer
Covering Legal and Regulatory Issues of Asset Management
VOL. 22, NO. 11 • NOVEMBER 2015

Advisory Contract Process: Still Under an SEC Enforcement Microscope

By Robert A. Robertson and Kimberley A. Church

The Securities and Exchange Commission (SEC) continues to focus on the mutual fund advisory contract approval process with its recent enforcement action against Commonwealth Management Capital, LLC and certain fund board members.[1] This action demonstrates the SEC's "broken windows" approach to enforcement[2] – even in cases where there is no apparent financial harm to fund shareholders. The SEC's stated goal is to protect the integrity of the process, which is outlined in Section 15(c) of the Investment Company Act of 1940 (1940 Act).

This article examines the *Commonwealth* case and other Section 15(c) cases in recent years.[3] We include relevant observations for investment advisers, fund boards, and independent directors.

Statutory and Judicial Requirements

Approving and renewing a mutual fund's advisory agreement, which must be set forth in a "written contract," is one of the most important duties of a fund's board of directors.[4] Courts have suggested that "[t]he expertise of the trustees, whether they are fully informed, and the extent of care and conscientiousness with which they perform their duties are among the most important factors to be examined in evaluating the reasonableness of [a fund adviser's] compensation."[5]

The 1940 Act prescribes specific procedural requirements for entering into and renewing an advisory agreement. These requirements for the most part are contained in Section 15.[6] The role of the directors, especially the independent directors, is central to this process.[7]

Section 15(a) provides that an advisory agreement may continue in effect for more than two years only if it is "specifically approved at least annually by the board of directors."[8] The Section requires that the initial agreement and any renewals be "approved by the vote of a majority of the directors," who are *not* parties to the agreement or "interested persons" of any such party.[9] The independent directors must cast their vote "in person at a meeting called for the purpose of voting on such approval."[10] Section 15(c) also provides:

> It shall be *the duty of the directors of a registered investment company to request and evaluate,* and the duty of an investment adviser to such company to furnish, *such information as may reasonably be necessary* to evaluate the terms of any [advisory] contract.[11]

Courts and the SEC have articulated relevant factors that may be "reasonably necessary" to evaluate an advisory contract's terms. These factors are known as the *Gartenberg* factors after the seminal case in this area.[12] These factors generally include:

- The nature and quality of the adviser's services;
- The performance of the fund and the adviser;
- The adviser's cost in providing services to the fund;
- The profitability of the fund to the adviser;
- The extent to which the adviser realizes economies of scale as the fund grows larger;
- Fee structures for comparable funds;
- Any "fall-out" benefits accruing to the adviser or its affiliates; and
- The independence, expertise, care, and conscientiousness of the board.[13]

Commonwealth Enforcement Action Background

On June 17, 2015, the SEC charged an adviser, Commonwealth Capital, LLC (Commonwealth), its principal and three mutual fund trustees with various Section 15(c) violations based on incomplete or inaccurate information in connection with the advisory contract approval process for two mutual funds advised by Commonwealth. The SEC also charged the funds' administrator with failing to disclose the board's considerations in one of the fund's shareholder reports, in violation of Section 30(e) and Rule 30e-1 thereunder.[14]

The funds – World Funds Trust (WFT) and World Funds, Inc. (WFI) – offered turnkey mutual funds managed by various unaffiliated advisers and sub-advisers. Each fund identified in the SEC action was advised by Commonwealth, which delegated its portfolio management responsibilities to certain sub-advisers. In most cases, the funds shared common service providers that administered day-to-day "back office" operations.

WFT's board consisted of three trustees, two of whom were independent (WFT Trustees). Although the independent WFT Trustees were entitled to compensation for their service, they voluntarily waived such compensation for the entire period they served on the board for the benefit of WFT shareholders. WFI's board consisted of four directors, three of whom were independent (WFI Directors). John Pasco, III, the principal of Commonwealth and the administrator, was WFI's sole interested director.

The SEC's action relates to three advisory contract approvals pursuant to Section 15(c):

- The initial approval of advisory contracts between each WFT Fund and Commonwealth in 2008;
- The renewal of the advisory contract between the WFI Fund and Commonwealth in 2009; and
- The renewal of the advisory contract between the WFI Fund and Commonwealth in 2010.

Commonwealth's Alleged Section 15(c) Violations

Violations Regarding the WFT Funds (2008)

According to the SEC, Commonwealth, in 2008, did not furnish, and the WFT Trustees did not have, all the information the board requested as reasonably necessary to evaluate the Funds' advisory contracts. The SEC focused on deficiencies with regard to comparative fee information and information regarding the nature and quality of Commonwealth's services to the Funds.

Comparable Fund Fees

The WFT Trustees had requested that Commonwealth and Mr. Pasco submit comparative fee information with the completed 15(c) questionnaire, but "[t]here [was] no documentary evidence that [the firm] furnished information regarding the fees paid by comparable funds."[15] Nevertheless, the WFT Trustees approved the advisory contracts because they considered the proposed advisory fees to be within an appropriate range.

Nature and Quality of Services

The SEC claimed that Commonwealth's 15(c) response did not permit the board to sufficiently evaluate the nature and quality of the firm's services.

Commonwealth's 15(c) response stated that the sub-adviser was responsible for portfolio management, and that Commonwealth would conduct oversight of the sub-adviser through quarterly and annual due diligence reviews. However, the Funds' advisory and sub-advisory contracts used "nearly identical language" to describe the services to be provided by each firm (except that the sub-adviser's duties were subject to Commonwealth's "supervision").[16]

Commonwealth's 15(c) response outlined certain duties of the administrator with respect to portfolio management compliance and reporting, but did not articulate what portfolio management compliance services Commonwealth itself would perform. Accordingly, the SEC concluded that the WFT Trustees did not receive complete responses concerning Commonwealth's services, and "did not request or receive additional materials."[17]

The WFT Trustees, according to the SEC, "were obligated to evaluate [Commonwealth's] services as compared to the fees provided for in the advisory contracts," even though, during the relevant period, Commonwealth waived the WFT Funds' advisory fee pursuant to a contractual fee waiver.[18] Commonwealth also reimbursed the majority of the Funds' operating expenses pursuant to an expense limitation agreement.

Violations Regarding the WFI Fund (2009)

The SEC found that, in 2009, Commonwealth did not furnish, and the WFI Directors did not have, all the information the board requested as reasonably necessary to evaluate the Fund's advisory contract. The SEC focused on deficiencies in information provided by Commonwealth regarding its advisory fee, profitability, expenses waived under the Fund's contractual expense limitation agreement and economies of scale.

Comparable Fund Analysis

As with the WFT Funds, here the SEC again focused on deficiencies with regard to comparative fee information. In this instance, Commonwealth provided a table of comparative fee information. However, in order to avoid "claims of 'cherry-picking' exemplar funds," Commonwealth did not edit the table to delete information for share classes and funds that were not directly comparable to the WFI Fund. Based on this approach, the SEC concluded that the table contained "numerous inapt comparisons."[19] In the comparative fee table, the SEC also noted the following:

- Fund share classes with different distribution fee structures;
- Assets at a share-class level rather than total-fund level;
- Different types of funds (including an exchange-traded fund, or index-based ETF, and an unmanaged index fund);
- Funds with different fee structures (including funds with a combined advisory and administration fee, even though the WFI Fund had a separate advisory and administration fee); and
- Missing or incomplete information in the table.

Commonwealth provided the board with two additional charts that compared the WFI Fund's expense ratio and advisory fee to those of selected funds from the table. The SEC observed that:

- The first chart compared the total expense ratio of the WFI Fund to four Commonwealth-selected funds with different share classes. Two of the funds had an expense ratio that included a 1.00% 12b-1 fee, while the WFI Fund class A had a 12b-1 fee of 0.25%. The chart also erroneously depicted one comparative fund's 12b-1 fee rather than its expense ratio.
- The second chart compared the WFI Fund's advisory fee to the same four funds. Two of the funds had a combined advisory and administration fee. However, the WFI Fund had a separate administration fee. The SEC stated that a true advisory fee comparison required adding the WFI Fund's separate administration fee (0.20%) to its advisory fee (1.25%).

Profitability and Allocation of Costs and Expenses

The 15(c) questionnaire asked that Commonwealth provide "all reasonably available financial information," including two years of financial statements, to assist the board in assessing the adviser's profitability.[20] The questionnaire also asked for a description of the basis and methodology for allocating indirect costs, overhead, and other costs to the Fund. However, Commonwealth only provided an income statement (and no balance sheet) for only one year. The firm provided a profitability chart that estimated overhead and other expenses for the same year, but the SEC noted that the chart did not include any written description of the expense allocation methodology.

Expense Limitation Agreement

Pursuant to the WFI Fund's expense limitation agreement, Commonwealth agreed to waive or limit its advisory fee if Fund expenses exceeded 2.75 percent. The 15(c) questionnaire requested that the firm provide the dollar amount of fees waived under the expense limitation agreement since the last contact renewal. Commonwealth's 15(c) response stated that no fees were waived – even though Commonwealth actually waived a portion of its advisory fee in accordance with the expense limitation agreement.

Economies of Scale

The 15(c) questionnaire requested an analysis regarding the adequacy and appropriateness of any WFI Fund advisory fee breakpoints. Commonwealth informed the WFI Directors that the Fund had implemented breakpoints and that the breakpoints were appropriate. All parties believed that earlier contract breakpoints had been provided for in the current agreements; however, the understood breakpoints were omitted from the current advisory contract.

Violations Regarding the WFI Fund (2010)

The WFI Directors held its next annual 15(c) review of the advisory and sub-advisory contracts for the WFI Fund in 2010. As was the case for the 2009 review, the SEC alleged that Commonwealth's performance and fee comparison charts were deficient, and that information regarding Commonwealth's profitability did not fully explain Commonwealth's entries or its methodology for allocating expenses and provided only a single year's financial statements.

Based on the above-noted SEC's findings in 2008, 2009, and 2010, the SEC determined that Commonwealth did not provide all the information requested by the boards as reasonably necessary for their evaluation (and in some instances, as to the WFI Fund, included inaccurate information). Further, the independent trustees/directors of the Funds did not follow up to obtain such information. Accordingly, the SEC found that Commonwealth and the independent trustees/directors willfully violated Section 15(c), and Mr. Pasco caused the firm's violations.

15(c) Disclosure Violations

The SEC also found that the WFI Fund's administrator did not include a summary of the Section 15(c) evaluation process in a 2010 WFI Fund shareholder report. The administrator was contractually responsible for preparing the shareholder report, but it inadvertently omitted the text containing the 15(c) information. Based on these facts, the SEC found that Commonwealth caused the Fund's violations of the 1940 Act provisions that require a fund to provide the discussion of the 15(c) process in its shareholder report.

SEC Sanctions

In the SEC settlement, the SEC ordered that:

- The respondents cease and desist from further violations of Section 15(c) and the shareholder report disclosure requirements;
- Each trustee of the WFI Funds pay a civil penalty of $3,250; and
- Commonwealth, the administrator and Mr. Pasco jointly pay a civil penalty of $50,000.

The independent directors of the WFI Fund were not parties to the SEC settlement. It is not clear whether the SEC is pursuing an action against those directors.

Lessons Learned from *Commonwealth*

In the SEC press release announcing the *Commonwealth* settlement, the Director of the SEC's Enforcement Division stated, "As the first line of defense in protecting mutual fund shareholders, board members must be vigilant.... These trustees failed to fully discharge their fund governance responsibilities on behalf of fund shareholders."[21] The Co-Chief of the Division's Asset Management Unit went on to state, "The advisory fee typically is the largest expense reducing investor returns. The WFT [T]rustees fell short as the shareholders' watchdog by essentially rubber-stamping the adviser's contract and related fee."[22]

Considering the facts of this case, *Commonwealth* represents the SEC's intense focus on the 15(c) process, regardless of the substantive outcome of that process. The advisory contract approval and renewal process is at its core concerned about quality of services provided and fees charged for those services. In *Commonwealth*, there was evidence of below par documentation, but none of the SEC's allegations indicated that the advisory services were unacceptable. Moreover, Commonwealth waived all or a portion of its advisory fees for the Funds during the relevant period and reimbursed the majority of the WFT Funds' operating expenses under an expense limitation agreement. The independent WFT Trustees also voluntarily waived their compensation for the entire period they served on the WFT Funds' board.

As *Commonwealth* demonstrates, the SEC is focused on the integrity of the 15(c) process. Even if, as the SEC claims, the WFT Trustees "rubber-stamped" management's fees, there was no evidence that the Funds' shareholders were harmed in light of services provided or fees charged.

It is also noteworthy that the independent directors of the WFI Fund were not parties to the SEC's settlement order. Perhaps the SEC's investigation is ongoing for those directors, or the SEC viewed their reliance on independent counsel as a mitigating factor in not making claims against those persons.

Predecessor Section 15(c) Enforcement Actions

The *Commonwealth* case follows a string of prior SEC enforcement actions under Section 15(c). Within the last several years, these actions have included:

Manipulating Profitability Methodology

In *Kornitzer Capital Management* (2015), the investment adviser to certain funds and the adviser's CFO/CCO allegedly provided inaccurate and incomplete information to the funds' board of trustees in connection with the funds' advisory contract renewal process.[23] Each year from 2010 through 2013, the board requested an analysis of the adviser's profitability in managing the funds, including an explanation of the adviser's methodology for allocating its expenses among the funds and other clients.

The CFO/CCO, acting on behalf of the adviser, prepared and provided to the board the requested analysis and explanation of the adviser's expense allocation methodology. The methodology specifically represented that the adviser allocated all employee compensation expenses to the funds "based on estimated labor hours." Each year, however, the CFO/CCO actually adjusted the allocation of the compensation of the adviser's chief executive officer, in part, to achieve consistency of the adviser's reported profitability year over year. The CFO/CCO did not disclose this information to the board. As a result, the adviser did not furnish information that was reasonably necessary for the board to evaluate the terms of the advisory contracts, in violation of Section 15(c).

In the settled SEC action, the adviser and CFO/CCO were ordered to cease and desist from further violations and to pay a civil money penalty in the amounts of $50,000 and $25,000, respectively.

Inaccurate 15(c) Disclosures in Fund Shareholder Reports

In *Northern Lights Compliance Services* (2013), the SEC cited two turnkey mutual fund trusts for allegedly including inaccurate "boilerplate" 15(c) disclosures in the shareholder reports for certain funds.[24] During the relevant period, the trusts collectively included up to 71 funds, most of which were managed by different, unaffiliated advisers and sub-advisers. The funds shared a common administrator, CCO and board of trustees.

According to the SEC, the boilerplate disclosures either misrepresented material information considered by the trustees or omitted material information about how the trustees evaluated certain factors in connection with the 15(c) process. Most notably, certain shareholder reports referenced information or materials that were not in fact provided to the trustees for their consideration. The SEC alleged that the trustees caused the violations because the 15(c) disclosures were based on board minutes that were reviewed and approved by the trustees. The SEC also alleged certain compliance and recordkeeping violations.

In the settled SEC action, the administrator, CCO and trustees were ordered to cease and desist from further violations. The administrator and CCO also agreed to pay a $50,000 civil penalty and to engage an independent compliance consultant to address the violations. Commenting on the settlement, the Deputy Chief of the SEC Enforcement Division's Asset Management Unit stated that "[t]hese violations make clear that turnkey mutual fund arrangements can pose significant governance concerns, and trustees must be vigilant in ensuring that the funds they oversee meet their disclosure, compliance, reporting, and recordkeeping obligations."[25]

Inaccurate Claims about Proposed Investment Strategy

In *Chariot Advisors* (2014), an adviser and its principal were charged with misrepresenting to a fund's board the adviser's ability to implement the fund's proposed investment strategy, which included algorithmic currency trading.[26] At the time of the board's considerations in 2008 and 2009, the adviser was in the process of obtaining an algorithm or computer model capable of engaging in the currency trading that was described to the board.

During the board's 15(c) process, the adviser's principal touted the competitive benefits of the adviser's algorithmic currency trading in two presentations. In fact, the adviser did not yet possess any algorithms capable of engaging in such currency trading, and the principal failed to disclose the "nascent nature of his efforts to obtain an algorithm from other sources."[27] Moreover, after the fund launched, a company owned by the principal hired an individual trader who was allowed to use discretion on trade selection and execution. The false claims by the adviser and principal also directly led to misrepresentations and omissions in the fund's registration statement and prospectus filed with the SEC.

In the settled SEC action, the adviser and its principal were ordered to cease and desist from further violations, and the principal agreed to pay a civil money penalty in the amount of $50,000. In announcing these changes, the SEC emphasized that a fund's adviser must provide the board with the truthful information necessary to evaluate the advisory agreement.[28]

Overstated Sub-Advisory Services

In *Morgan Stanley Investment Management* (2011), the SEC charged a fund's adviser with improperly charging advisory fees from 1996 to 2007.[29] The adviser allegedly had represented to investors and the fund's board of directors that the fund's Malaysian sub-adviser was providing certain services that the sub-adviser in fact was not providing. In early 2008, after the SEC Examination Staff inquired into the fund's relationship with the sub-adviser, the sub-adviser's services were terminated.

Each year, in connection with the fund's annual advisory and sub-advisory contract approval process, the adviser submitted a report to the board

that claimed the sub-adviser was providing specific research, intelligence, and advice to the adviser. The adviser also submitted two compliance reports indicating that the sub-adviser was providing advisory services. Despite these claims, the sub-adviser's services were limited to preparing two minor monthly reports for the adviser, which the adviser's portfolio management team neither requested nor used. At the same time, the adviser, which was responsible for preparing the fund's shareholder reports, repeatedly issued reports that inaccurately represented that the sub-adviser was providing services to the adviser. As a result of these misrepresentations, the adviser did not provide the fund's board with information reasonably necessary for the board to evaluate the sub-adviser's services, in violation of Section 15(c). Further, the adviser did not adopt and implement procedures governing its oversight of the sub-adviser and the provision of information regarding the sub-adviser's services to the board in connection with the advisory contract renewal process.

In the SEC settlement, the adviser agreed to reimburse the fund in the amount of $1,845,000 in advisory fees. The adviser also was ordered to cease and desist from further violations and pay a civil penalty of $1,500,000. In the press release announcing a settlement, the SEC's Director of Enforcement stated, "We want to take the advisory fee setting process out of the shadows by scrutinizing the role of investment advisers and fund board members in vetting fee arrangements with registered funds."[30] The co-chief of the SEC's Enforcement Division's Asset Management Unit also commented that "[t]he adviser's failure undermined the integrity of the board's oversight process."[31]

Lack of Information Regarding a Fund Guarantee

In *New York Life Investment Management* (2009), the investment adviser to a mutual fund allegedly did not provide the fund's board of trustees with sufficient information to evaluate the cost of an S&P index fund guarantee.[32] From 2002 through June 2004, the fund's board of trustees approved the renewal of three investment advisory contracts between the adviser and the fund. For each contract renewal process, the board received information showing that the management fees the adviser charged to the fund were among the highest of the fund's peer-group of mutual funds.

The adviser urged the board to consider the "guarantee" feature of the fund in evaluating the management fees, but did not provide the board with information reasonably necessary to evaluate the cost of the guarantee, in violation of Section 15(c).[33] Moreover, at the same time that the adviser was claiming that the guarantee should be considered, the adviser was filing with the SEC prospectuses, annual reports, and registration statements in which it misrepresented that there was "no charge" to the fund or its shareholders for the guarantee. In the SEC settlement, the SEC ordered the adviser to cease and desist from further violations, pay disgorgement and prejudgment of $5,300,784, and a civil penalty of $800,000.

15(c) Lessons Learned

As the SEC stated in announcing the *Morgan Stanley* charges in 2011, the agency aims to "take the advisory fee setting process out of the shadows."[34] Enforcement actions since 2009 leading up to *Commonwealth* show that the SEC has accomplished this goal. The SEC continues to scrutinize the advisory contract approval and renewal process, even in cases where there is arguably no financial harm to fund shareholders, and is on the lookout for any gaps regarding the "integrity of the board's oversight process" – as well any substantive and intentional wronging.[35] This scrutiny follows through to a fund's "disclosure, compliance, reporting, and recordkeeping obligations."[36]

An analysis of the SEC's Section 15(c) cases highlights the importance of:

- *Board Guidance/Gartenberg Memorandum*. Independent counsel or fund counsel typically

prepares a memorandum advising the fund's board of directors and/or the independent directors of the directors' advisory contract responsibilities under the judicial standards – *Gartenberg* and its progeny. There is no legal requirement to prepare this document, but it is now industry practice.

- *Section 15(c) Request Letter*. Independent counsel or fund counsel typically prepares a letter requesting that fund management furnish the fund's board of directors and/or independent directors with information regarding the *Gartenberg* factors and other relevant information. Like the *Gartenberg* memorandum, there is no legal requirement to prepare a Section 15(c) request letter. However, the SEC has stated that the requested items in this document, in its view, constitute what is "reasonably necessary" to satisfy the Section 15(c) requirement to evaluate the terms of an advisory contract.
- *Section 15(c) Response*. Management's response to the Section 15(c) Request Letter – which is typically a written response – should be forthright. The response should address each requested item and/or explain why the requested item, in management's view, is not material to the contract's evaluation.
- *Board Deliberations, Follow-Up and Minutes*. Board considerations regarding advisory contract approvals and renewals should be thorough. The directors should follow up on Section 15(c) response items, if necessary. The board also could reasonably conclude that the record before it is sufficient, under the right facts and circumstances, to evaluate the terms of a contract and satisfy legal requirements. Board considerations should be well documented in the meeting minutes.
- *Shareholder Reports*. SEC rules require that a summary of a board's considerations regarding advisory contact approvals and renewals with respect to a mutual fund be disclosed in the fund's next shareholder report. Those disclosures should be an accurate summary of the actual factors considered.

Conclusion

Fund management, boards and independent directors should continue to ensure the integrity of the fund advisory contract evaluation process. Time and effort during the process may well avoid an SEC enforcement action after the fact.

Mr. Robertson is a partner, and **Ms. Church** is an associate, in the Orange County office of Dechert LLP.

NOTES

1 *In the Matter of Commonwealth Capital Management, LLC, et al.*, SEC Rel. No. IC-31678 (June 17, 2015).

2 "Remarks at the Securities Enforcement Forum," speech by SEC Chair Mary Jo White, Washington, DC (Oct. 9, 2013) ("The theory is that when a window is broken and someone fixes it – it is a sign that disorder will not be tolerated. But, when a broken window is not fixed, it 'is a signal that no one cares, and so breaking more windows costs nothing….' The same theory can be applied to our securities markets – minor violations that are overlooked or ignored can feed bigger ones, and, perhaps more importantly, can foster a culture where laws are increasingly treated as toothless guidelines. And so, I believe it is important to pursue even the smallest infractions.") (quoting George L. Kelling and James Q. Wilson, "Broken Windows: Police and Neighborhood Safety," *The Atlantic* (1998), available at *http://www.theatlantic.com/magazine/archive/1982/03/broken-windows/304465/*).

3 In *Commonwealth* and other Section 15(c) cases discussed herein, the respondents neither admitted nor denied the SEC's findings. Accordingly, all facts cited herein are based solely on SEC allegations, as reflected in the SEC's settlement orders.

4 Robert A. Robertson, Fund Governance: Legal Duties of Investment Company Directors

§ 6.03[1] (2015) (hereinafter, *Fund Governance Treatise*).

5 *Id.* (citing Kalish v. Franklin Advisers, 742 F. Supp. 1222 (S.D.N.Y. 1990), *aff'd,* 928 F.2d 590 (2d Cir. 1991), *cert. denied,* 502 U.S. 818 (1991)).

6 15 U.S.C. § 80a-15.

7 *Fund Governance Treatise* § 6.03[1].

8 15 U.S.C. § 80a-15(a)(2). Section 15(a) also requires that fund shareholders approve the initial advisory agreement. 15 U.S.C. § 80a-15(a). In practice, the adviser—as the fund's sole shareholder—will approve the agreement prior to the fund being offered to the public. For contract renewals, Section 15(a) permits a fund's shareholders to approve the continuance of an advisory agreement as an alternative to the full board's annual approval. 15 U.S.C. § 80a-15(a)(2). This provision is virtually never used in practice.

9 15 U.S.C. § 80a-15(c). Section 15(c)'s requirements are in addition to the requirements under Section 15(a). *See Fund Governance Treatise* § 6.02. The term "interested person" is defined in Section 2(a)(19) of the 1940 Act.

10 15 U.S.C. § 80a-15(c).

11 *Id.* (emphasis added).

12 Gartenberg v. Merrill Lynch Asset Mgmt., Inc., 694 F.2d 923 (2d Cir. 1982); *see also* Jones v. Harris Assocs., 559 U.S. 335 (2010). *See Disclosure Regarding Approval of Investment Advisory Contracts by Directors of Investment Companies,* Investment Company Act Rel. No. 26486 at n.31 (June 23, 2004).

13 *See Fund Governance Treatise* § 6.03[3]. *See also* SEC Form N-1A ("Factors relating to both the board's selection of the investment adviser and approval of the advisory fee and any other amounts to be paid by the Fund under the contract … would include, but not be limited to, a discussion of the nature, extent, and quality of the services to be provided by the investment adviser; the investment performance of the Fund and the investment adviser; the costs of the services to be provided and profits to be realized by the investment adviser and its affiliates from the relationship with the Fund; the extent to which economies of scale would be realized as the Fund grows; and whether fee levels reflect these economies of scale for the benefit of Fund investors.").

14 *In the Matter of Commonwealth Capital Management, LLC, et al.*, SEC Rel. No IC-31678 (June 17, 2015).

15 *Id.*

16 *Id.*

17 *Id.*

18 *Id.*

19 *Id.*

20 *Id.*

21 "SEC Charges Investment Adviser and Mutual Fund Board Members with Failures in Advisory Contract Approval Process," SEC Press Release 2015-124 (June 17, 2015) (hereinafter, *Commonwealth Press Release*).

22 *Id.*

23 *In the Matter of Kornitzer Capital Management, et al.*, SEC Rel. No IC-31560 (Apr. 21, 2015).

24 *In the Matter of Northern Lights Compliance Services, LLC et al.*, SEC Rel. No. IC-30502 (May 2, 2013).

25 "SEC Charges Gatekeepers of Two Mutual Fund Trusts for Inaccurate Disclosures About Decisions on Behalf of Shareholders," SEC Press Release 2013-78 (May 2, 2013) (hereinafter, *Northern Lights Press Release*).

26 *In the Matter of Chariot Advisors, LLC and Elliott L. Shifman*, SEC Rel. No. IC-31149 (July 3, 2014).

27 *Id.*

28 "SEC Charges North Carolina-Based Investment Adviser for Misleading Fund Board About Algorithmic Trading Ability," SEC Press Release 2013-162 (Aug. 21, 2013).

29 *In the Matter of Morgan Stanley Investment Management*, SEC Rel. No IC-29862 (Nov. 16, 2011).

30 "SEC charges Morgan Stanley Investment Management for Improper Fee Arrangement," SEC Press Release 2011-244 (Nov. 16, 2011) (hereinafter, *Morgan Stanley Press Release*).

31 *Id.*

32 *In the Matter of New York Life Investment Management LLC*, SEC Rel. No IC-2883 (May 27, 2009).

[33] Pursuant to the guarantee, an affiliate of the adviser agreed to make up any shortfall if the value of a shareholder's investment in the fund on the tenth anniversary of his or her investment was less than his or her original investment, provided the shareholder remained in the fund for the entire period and reinvested all distributions. As a result of the stock market decline in 2008, the affiliate paid approximately $8.9 million to shareholders of the fund under the terms of the guarantee.

[34] *Morgan Stanley Press Release*, *supra* n.30.

[35] *Id.*

[36] *Northern Lights Press Release*, *supra* n.25.