Best practices in Mutual Fund Shared Trusts

How asset managers can efficiently operate a registered investment fund

The long established shared trust structure is experiencing significant growth of mutual funds, assets, and investment managers from both startup and existing mutual fund complexes. A shared trust, sometimes referred to as a Multiple Series Trust (“MST”), is an open-end investment management company (mutual fund) that is organized as a series trust. The MST structure is typically sponsored by a service provider and is utilized by multiple, unrelated investment management firms to house their mutual fund products. Each fund is a portfolio, or “series,” of the Trust. The Trust, through its Board and service providers, performs management of all fund operations, governance, servicing, and administration, allowing the manager to focus on its core competency, investment management. Historically, MSTs were utilized by advisers with limited assets under management as an inexpensive means of offering a mutual fund family with small assets. Today, in addition to their historical role, MSTs are also a viable option for large managers to efficiently and cost-effectively manage the compliance, operational and governance of their mutual fund products.

Why the success of Multiple Series Trusts?

There are several reasons for the proliferation of funds within the MST structure, not the least of which is the regulatory environment now facing investment firms managing mutual fund products. The increased complexity of the mutual fund industry creates significant compliance requirements for the fund complex. The investment manager must now weigh the business risks associated with their advisory firm sponsoring and operating a proprietary fund, compared to the outsourced MST mutual fund model. The implementation of SEC Rule 38a-1 amplified the compliance and risk management requirements placed upon the adviser of a proprietary fund. The SEC has tasked mutual fund board members with increased responsibilities, making it more difficult to secure qualified mutual fund board members and more complicated for them to fulfill their role as Trustee. Those new requirements, coupled with increased governance requirements and the fiduciary responsibilities of mutual fund Trustees, have contributed to investment managers selecting the MST structure.
The SEC requires that a mutual fund retain a qualified Chief Compliance Officer (CCO) to perform very specific and intensive fund compliance monitoring. The Rule 38a-1 requirements necessitate a seasoned industry veteran to assess, interpret, and report on the compliance infrastructure to the Fund Board. In a proprietary fund model, the CCO role is typically performed by either the adviser CCO or a dedicated mutual fund CCO. Advisers are faced with either adding an experienced senior compliance manager or adding the fund CCO title and duties to the adviser's CCO, which can create additional, and sometimes unfamiliar, responsibilities for this adviser compliance individual. In a MST, an experienced fund CCO is provided as a component of the model.

**MST Fund compared to Proprietary Fund**

The single biggest difference between an MST fund and a proprietary fund is the shared MST legal entity and infrastructure. The MST fund leverages the existing Board, service providers, and policies and procedures of the MST. Each investment manager would require these elements of the fund operations to be replicated if they chose the proprietary model for their mutual funds.

### Mutual fund structures*

<table>
<thead>
<tr>
<th>Trust</th>
<th>Multiple Series Trust (MST)</th>
<th>Proprietary</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Description:</strong></td>
<td>A MST is an existing open-end SEC registered investment management company consisting of a series of mutual funds managed by unaffiliated investment advisers. Each fund is a separate “series” or separate portfolio within the trust, allowing multiple, unaffiliated advisers to gain economies of scale within one fund complex, sharing a common board, independent legal counsel, audit firm, and service providers.</td>
<td>A proprietary trust is typically established specifically for a single investment manager's product line and distribution strategy. The investment manager takes the lead in organizing the trust and is actively involved in the daily operations and administration of the trust and the trust board meetings.</td>
</tr>
<tr>
<td><strong>Fund board of trustees:</strong></td>
<td>In place, with mutual fund industry experience; the mutual fund board generally includes an interested Trustee affiliated with the administrator.</td>
<td>Generally selected and recommended by the investment manager; the mutual fund Board generally includes an interested Trustee affiliated with the investment manager.</td>
</tr>
<tr>
<td><strong>Fund officers (president, treasurer, assistant treasurer, secretary):</strong></td>
<td>In place, provided by the MST, approved by the Trustees; generally employees of the administrator.</td>
<td>Generally selected and recommended by the investment manager, approved by the Trustees; generally employees of the adviser.</td>
</tr>
<tr>
<td><strong>Investment manager role:</strong></td>
<td>Adviser, approved by the Board of Trustees.</td>
<td>Adviser, approved by the Board of Trustees.</td>
</tr>
<tr>
<td><strong>Service providers:</strong> (administrator, accountant, custodian, distributor, transfer agent, legal counsel, audit)</td>
<td>In place, provided by the MST, approved by the Trustees.</td>
<td>Generally selected and recommended by the investment manager, approved by the Trustees.</td>
</tr>
<tr>
<td><strong>Fund Chief Compliance Officer</strong></td>
<td>In place, provided by the MST, approved by the Trustees.</td>
<td>Generally selected and recommended by the investment manager, approved by the Trustees; commonly performed by the adviser CCO staff.</td>
</tr>
<tr>
<td><strong>Estimated implementation time</strong></td>
<td>Generally 100-120 days.</td>
<td>Generally 150-180+ days.</td>
</tr>
<tr>
<td><strong>Mutual fund branding</strong></td>
<td>Determined by the investment manager.</td>
<td>Determined by the investment manager.</td>
</tr>
<tr>
<td><strong>Active distribution</strong></td>
<td>Typically provided by the investment manager.</td>
<td>Typically provided by the investment manager.</td>
</tr>
</tbody>
</table>
Indicated below are the fund operations that are shared by funds within a MST:

- Independent legal counsel
- Independent audit firm
- MST Board of Trustees
- Trust level policies and procedures
- Service provider structure – Fund Administration, Fund Accounting, Transfer Agent, Custody, Distributor
- Trust Chief Compliance Officer
- Fund Officers

**MST advantage**

The investment manager can benefit from the MST business model through several advantages, including timing, cost savings, governance expertise, administrative efficiencies, and compliance benefits.

**Reduced time to market** - Since the MST is an existing SEC trust registration, any new funds are simply additional series added to the original registrant. There are two time components to launching a mutual fund - registration drafting and SEC review period. A new MST series drafting process generally takes 30 days whereas drafting a new proprietary trust/series fund can take 60-90 days. The SEC normally will declare a new MST series fund effective in 75 days. Although the SEC makes no commitment as to the time required to approve a new registrant, 90-120 filing days for a new proprietary trust is not uncommon.

**Cost advantages** – A MST provides economies of scale for certain fund startup and annual operating costs. Startup costs are lower, principally because the amount of legal work required to add a series fund to an existing trust is less extensive than establishing an entirely new trust.

In addition, certain annual operating expenses for a fund within an MST are reduced due to the allocation of certain costs across all funds within the Trust, such as:

- Trustee expenses
- Trust level legal counsel costs
- Certain state Blue Sky permit costs
- Fidelity bond insurance coverage
- Directors and Officers insurance coverage

**Governance and service expertise** – MST fund managers benefit from the experience and expertise of an existing board of Trustees familiar with mutual fund regulatory and operational issues. The Trustees provide a sounding board to the fund manager, which can help avoid costly missteps. In addition, the manager benefits from the existing MST service provider structure, talent, and technology.

- MSTs offer experienced mutual fund board members and governance processes.
- MSTs provide experienced fund officers and service infrastructure, helping to reduce the business risks associated with the adviser’s role in the operation of the mutual fund to primarily investment management and portfolio compliance.
- The service provider will partner with the MST investment managers to improve efficiencies and provide best practice advice.
Compliance infrastructure – The MST structure provides several compliance advantages for the adviser, typically duties assumed by the adviser in a propriety fund structure.

- MST Trustees are entirely independent of the advisers within the Trust, creating a true “arm’s length” arrangement between the fund and the adviser. This independence has been a significant SEC focus.
- MST sponsors provide an experienced Chief Compliance Officer for all funds within the Trust, offering proven expertise and guidance to each manager.
- MST sponsors provide the Sarbanes-Oxley monitoring and certification for all fund financial reporting.

Administrative efficiencies – By adding mutual funds to an existing MST, the following required services are in place, saving the time and effort of due diligence to search for and select parties to support the fund. The organizational tasks involve registering the new fund with the SEC.

- Board members – qualification, selection and education
- Consolidated Board meetings
- Common service providers – Fund Administration, Fund Accounting, Transfer Agent, Custody, Distributor
- Common Chief Compliance Officer
- Common independent legal counsel
- Common independent audit firm
- Shared insurance coverage

Fig. 1
The graphic in Figure 1 details the fiduciary oversight the Board of Trustees has with respect to governing the funds, advisers, and service providers to the MST.
MST trustee responsibilities

The responsibilities of the MST Board members are identical to those of a proprietary fund trustee. Each mutual fund trustee has a fiduciary duty to represent and protect the interests of the investors of the fund(s) – the duty of care and duty of loyalty. The Board will set and review investment and operational policies for the MST, contract with, and oversee the performance of all service providers. The Trustees will oversee the investment adviser, ensure compliance with specific requirements of the 1940 Act, Subchapter M of the Internal Revenue Code, and all applicable federal and state securities laws.

Investment manager responsibilities in a MST

The investment manager’s responsibilities to the fund and Trust are primarily investment management, with compliance and administrative reporting to the Trustees. The manager is a service provider to the Trust, hired and monitored by the Trustees on behalf of the shareholders. At the launch of the fund, the investment manager will determine the investment strategy of the portfolio(s), assist in the design and branding of the prospectus and fund materials, determine the class and fund expense structure, select the fund name, and develop and implement a distribution strategy. Once the fund is operational, the investment manager will manage the investments, actively promote and distribute the fund(s), and provide quarterly portfolio and management information to the MST Trustees.

Initial board meeting – The investment manager will present the summary of the mutual fund business plan to the MST Trustees for approval as an additional series of the Trust. The presentation typically includes a review of the adviser business, portfolio management team, the adviser’s compliance program, policies and procedures, and distribution strategy planned for the fund, including anticipated asset growth.

MST quarterly board submission – Prior to each MST board meeting, the investment manager will provide a portfolio summary for review by the Trustees. This adviser summary will generally include fund performance, discussion of performance attribution, market review and outlook, and an adviser organization update. In addition, U.S. Bancorp Fund Services will add fund information including fund performance, top holdings, sector weightings, statement of assets and liabilities, fund expenses, and shareholder subscription/redemption activity.

Contract renewal – Once per year, the manager will participate in a Board meeting in person to present portfolio, adviser, and compensation information to the Board as a component of the Board’s due diligence process for review and renewal of the investment management contract.

CCO due diligence – Generally once per year, the MST CCO, on behalf of the Trust and Trustees, will travel to the investment manager’s office to perform a due diligence review of the manager’s trading practices and compliance infrastructure. The results are included in the CCO’s report to the MST Trustees.
**MST fund startup tasks**

The MST sponsor (e.g., U.S. Bancorp Fund Services) manages all of the legal and operational tasks involved in establishing a fund within a MST, guiding the investment manager through the regulatory and implementation issues. The initial task involves drafting the fund registration materials that will describe the investment strategy proposed by the investment manager. The MST sponsor will establish all fund policies, procedures and operations such as valuation procedures, code of ethics, privacy policy, fidelity bond insurance, service agreements, distribution plan, shareholder servicing plan, fund expense projection, AML compliance procedures, and more. Indicated in the chart below is an approximate timeline for establishing fund(s) within a MST.

<table>
<thead>
<tr>
<th>Days prior to SEC effectiveness</th>
<th>Mutual fund implementation task</th>
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<tbody>
<tr>
<td>120 days</td>
<td>Mutual fund business plan</td>
</tr>
<tr>
<td>100 days</td>
<td>Draft SEC registration materials</td>
</tr>
<tr>
<td>90 days</td>
<td>MST board approval</td>
</tr>
<tr>
<td>80 days</td>
<td>Review &amp; revision of registration materials</td>
</tr>
<tr>
<td>75 days</td>
<td>SEC filing</td>
</tr>
<tr>
<td>40 days</td>
<td>Investment management contract approval</td>
</tr>
<tr>
<td>30 days</td>
<td>SEC comments</td>
</tr>
<tr>
<td>5 days</td>
<td>SEC amendment filing</td>
</tr>
<tr>
<td>Effective date</td>
<td>SEC declares product effective</td>
</tr>
<tr>
<td>Effective date + 5</td>
<td>Definitive prospectus filing</td>
</tr>
</tbody>
</table>

**Fig. 2**

The table in Figure 2 is an approximate timeline for establishing fund(s) within a Multiple Series Trust.

**Parting thoughts**

While MSTs have been operating since at least 1987, we anticipate that their current popularity will continue, primarily due to the increasing complexity of the mutual fund industry, specifically in the areas of compliance and governance. Investment managers that choose to focus their talent and resources toward investment management and asset gathering will continue to see the advantages inherent in the MST structure.
About the author
Bob Kern is a Managing Director and Executive Vice President of U.S. Bancorp Fund Services, LLC. He began his career with U.S. Bancorp in 1982 and has served as a manager within the fund services subsidiary since 1984. From 1984 to 1994, Bob managed business development efforts as well as the mutual fund Transfer Agent operation including the Investor Services group, Account Services, Legal Compliance, Document Processing, and Systems Support divisions. During that time, Bob assisted in the management and implementation of both services and technologies related to Transfer Agent and shareholder services, Fund Accounting, Fund Administration, literature fulfillment, and fund distribution services.

Education and credentials
Bob received his undergraduate degree from Marquette University in business administration with specializations in finance and marketing. Bob serves as a board member of U.S. Bancorp Fund Services, LLC, Quasar Distributors, LLC, and interested Trustee and Chair of Managed Portfolio Series, an open-end mutual fund multiple series trust.

About us
For more than 45 years, U.S. Bancorp Fund Services has leveraged specialized experience across our organization to provide seamless service solutions for our clients regardless of the complexity and depth of their products. With client relationships lasting since our inception, we know the foundation for strong relationships is built on open communication, trust, and accountability. Our managers and professionals will deliver the amount of support, guidance, and insight into the market our clients need to be successful.

Headquartered in Milwaukee since 1969, U.S. Bancorp Fund Services currently provides services to more than 556 alternative, ETF and mutual fund clients with 3,352 portfolios and aggregate assets of $959 billion as of December, 2016. Our clients include mutual funds, investment partnerships, hedge funds, separately managed accounts, fund-of-funds, and offshore funds. It is a subsidiary of U.S. Bank, N.A., the fifth largest commercial bank in the United States with assets of $454 billion, noted in the third quarter 2016 corporate profile.

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