Articles
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Examining the Section 15(c) Contract Review Process for Similar ETFs and Mutual Funds

As the number of exchange-traded funds (ETFs) continues to grow rapidly across the industry, boards increasingly find themselves at a crossroads in their annual contract review process under Section 15(c) of the Investment Company Act of 1940, as amended (1940 Act), questioning whether they are compelled to consider the delicate question of comparability of fees and other matters between ETFs and mutual funds. Boards must be careful in this position to ensure they do not find themselves in the crosshairs of regulators or litigants.

ETFs and mutual funds share many similarities as pooled investment vehicles that allow investors to benefit from the professional management of their money. But they differ in fundamental ways that directly impact the economics both for managers and fund shareholders. Understanding these differences is key to appropriately comparing ETFs and mutual funds in the 15(c) context. In developing a framework for boards to use as they navigate this new terrain, this article reviews market developments and applicable law and offers guidelines for application of the law in the context of 15(c) comparisons of mutual funds and ETFs. We conclude that boards overseeing funds in a complex that includes similar ETFs and mutual funds with the same or affiliated managers may generally wish to compare the two products as part of the 15(c) process. On the other hand, where similar ETFs and mutual funds are managed by unaffiliated managers, boards may likely conclude the comparison is "inapt," and not appropriate for inclusion in the 15(c) process, in view of the differing fee structures and services provided.

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