AFFEs Are Not Paid Out by the ETF or Any Other Fund of Funds Directly, But Indirectly

Acquired Fund Fees and Expenses (AFFEs) are not fees that ETF investors or any other Fund of Funds investors that invest in Business Development Companies (BDCs) pay **directly**. Instead, they represent the **indirect expenses** embedded in the operating and management structures of the underlying funds in which the ETF invests.

When an ETF invests in a Business Development Company (BDC), the underlying company already incurs its own expenses. These may include:

- Operating costs such as payroll, administration, or professional services
- Management fees charged by the BDC's external advisor
- Performance-based or incentive fees
- Interest expense tied to the BDC's use of leverage

These expenses are paid **by the underlying BDC itself**, not by the ETF. They are reflected in the BDC's **financial statements, net investment income, and market price**, ultimately influencing the return profile of the ETF that holds those BDCs.

However, ETF **does not remit these expenses**, does not accrue them daily, and they **do not reduce the ETF's net asset value** in the way direct expenses do.

The SEC requires ETFs that hold BDCs to disclose AFFEs so investors understand the total expense structure inherent in the underlying holdings. But it is essential to emphasize that AFFEs are **strictly a disclosure item**. They:

- Do **not** appear in the ETF's financial statements
- Do **not** reduce the ETF's NAV directly
- Does **not** represent an additional fee charged to ETF shareholders

Instead, AFFEs serve to inform investors that the ETF's performance already reflects the economics of the acquired funds, including any management or operating costs built into those underlying entities.

Summary

Type of Expense	Where it Comes From	Who Pays	Disclosures in ETF Financials	SEC Prospectus Disclosure
Direct Expense	ETF Operations	ETF Investors	Yes, Appears in ETF Financials	Yes
AFFEs	BDCs Operating Expenses	Not by ETF Investors but embedded in the ETF's return	No	Yes (Required)

SEC Rule for Acquired Fund Fees and Expenses

The Origin of Business Development Companies goes back to 1980 when **US Congress** made amendments to the **Investment Company Act of 1940**. The goal was to expand the flow of capital to **small and middle-market American businesses**, which historically had limited access to institutional financing.

BDCs are publicly traded corporations, so they bear corporate-style expenses (G&A, payroll, executive compensation, interest expense). These **internal operating costs (explained in section #1)** indirectly flow through shareholders via the BDC's market price and net investment income. When an ETF holds a BDC, those internal costs indirectly affect the ETF's performance, even though the ETF or any Other Fund of Funds that invests into BDCs does not pay those expenses itself.

In **2006**, the SEC adopted a set of rules to increase transparency for "fund-of-funds" structures. These rules required any fund investing in other registered funds, including ETFs holding BDCs to disclose:

- **Direct fund expenses** (paid by the ETF itself)
- **Acquired fund fees and expenses (AFFEs)**, which represent the expenses charged inside the underlying funds

Future of AFFE disclosure for ETFs and other Fund of Funds

The future of AFFE disclosure is poised for meaningful change with the passage of the **Access to Small Business Investor Capital Act** in the House in **June 2025**. ASBICA directly addresses one of the most debated aspects of the AFFE rule the treatment of Business Development Companies (BDCs) inside ETF and Fund of Funds fee tables.

ASBICA seeks to correct this issue by allowing ETFs and other registered investment companies to **exclude BDC** related expenses from the AFFE calculation. If enacted, funds that invest in

BDCs (including ETFs offering exposure to private credit, private equity-style strategies, and publicly listed BDC baskets) **would no longer** be required to show BDC internal expenses as part of their own expense ratios. This change preserves transparency BDCs will still report their own publicly disclosed fee structures while eliminating what industry participants view as misleading "**double counting.**"

The bill still must pass the Senate and be signed into law before becoming effective.

Important Notice

Investors should consider the investment objectives, risks, charges and expenses carefully before investing.

Investments involve risk. Principal loss is possible. Redemptions are limited and often commissions are charged on each trade. Unlike mutual funds, ETFs may trade at a premium or discount to their net asset value.

Investment Risk. When you sell your Shares of the Fund, they could be worth less than what you paid for them. The Fund could lose money due to short-term market movements and over longer periods during market downturns. Securities may decline in value due to factors affecting securities markets generally or particular asset classes or industries represented in the markets.

Listed Private Equity Companies Risk. There are certain risks inherent in investing in listed private equity companies, which encompass financial institutions or vehicles whose principal business is to invest in and lend capital to or provide services to privately held companies. Generally, little public information exists for private and thinly traded companies, and there is a risk that investors may not be able to make a fully informed investment decision. The Fund is also subject to the underlying risks which affect the listed private equity companies in which the financial institutions or vehicles held by the Fund invest. Listed private equity companies are subject to various risks depending on their underlying investments, which include additional liquidity risk, industry risk, foreign security risk, currency risk, valuation risk and credit risk.

Business Development Company (BDC) Risk. BDCs generally invest in less mature U.S. private companies or thinly traded U.S. public companies which involve greater risk than well-established publicly traded companies. While the BDCs in which the Fund invests are expected to generate income in the form of dividends, certain BDCs during certain periods of time may not generate such income. The Fund will indirectly bear its proportionate share of any management fees and other operating expenses incurred by the BDCs and of any performance-based or incentive fees payable by the BDCs in which it invests, in addition to the expenses paid by the Fund.

Master Limited Partnership Risk. An MLP is an entity that is classified as a partnership under the Internal Revenue Code of 1986, as amended, and whose partnership interests or "units" are traded on securities exchanges like shares of corporate stock. Investments in MLP units are subject to certain risks inherent in a partnership structure, including (i) tax risks, (ii) the limited ability to elect or remove management or the general partner or managing member, (iii) limited voting rights and (iv) conflicts of interest between the general partner or managing member and its affiliates and the limited partners or members.