To: **J. P. Morgan Funds Board of Trustees**

From: **Steve Ungerman**

Date: **August 16, 2017**

Re: **Senior Officer Report**

I have prepared this 2017 Senior Officer report for the J. P. Morgan Funds Board of Trustees pursuant to the Assurance of Discontinuance between Banc One Investment Advisors Corporation (and its successor, J. P. Morgan Investment Management Inc. – the "Adviser") and the New York State Attorney General (the "AG Agreement"). The purpose of the report is to assist the trustees in determining the reasonableness of the proposed management fees of each J. P. Morgan Fund covered by the AG Agreement. The report will be presented to the trustees at the upcoming August 2017 Board meeting.

I. OVERVIEW OF EVALUATION PROCESS

A. Background

Under the AG Agreement, the Senior Officer is required to manage "the process by which proposed management fees (including, but not limited to, advisory fees) to be charged a Fund are negotiated so that they are negotiated in a manner which is at arms' length and reasonable and consistent with" the AG Agreement. It specifically states that the Adviser may manage or advise a Fund only if the reasonableness of the proposed management fees is determined by the Board of Trustees using a competitive bidding process or an annual independent written evaluation prepared by or under the direction of the Senior Officer. The AG Agreement requires the Senior Officer evaluation to consider at least the following factors:

- The nature and quality of the Adviser's services, including Fund performance;
- Management fees charged by other mutual fund companies for like services;
- Management fees charged to institutional and other clients of the Adviser for like services;
- Possible economies of scale as the Fund grows larger;
- Costs to the Adviser and its affiliates of supplying services pursuant to the management fee agreements, excluding any intra-corporate profit; and
- Profit margins of the Adviser and its affiliates from supplying such services.

As directed by the Board, I have prepared this written evaluation taking into consideration the factors listed above. It should be noted that this evaluation is not meant to diminish the responsibility or authority of the Board to perform its duties under Section 15 of the Investment Company Act of 1940 and applicable state law.

B. Funds Covered by AG Agreement

As Senior Officer, I am required to evaluate the proposed management fees of each heritage One Group Fund listed in Schedule A of the AG Agreement, as well as any heritage J. P. Morgan Fund with which the listed Funds are merged (each, a "Fund" and collectively, the "Funds"). Therefore, the AG Agreement does not specifically apply to any heritage J. P. Morgan Fund which has not merged with a heritage One Group Fund. Accordingly, these heritage J. P. Morgan Funds are not included in the scope of this report.

C. Source of Information Reviewed

My evaluation is based on a review of information provided by management and independent consultants, and presentations made by business and portfolio management personnel as part of the Board's annual review process. This includes:

- Management prepared memoranda regarding services provided to the Funds under investment advisory and other agreements;

- Lipper Inc. analyses of Fund performance and expense levels compared to their competitive universe and peer groups;

- Management prepared summaries of Fund performance and expense rankings based on Lipper material (Quintile Summary Sheets);

- Management prepared Fund-by-Fund summaries of Lipper material (Fund Dashboards);

- Performance analyses prepared by Casey Quirk & Associates, an independent consultant engaged by the Board;

- Management prepared schedule of advisory fees charged to institutional and other Adviser clients;

- Management prepared profitability analyses of Adviser costs and profit margins related to the advisory, shareholder servicing, and administration agreements with the Funds (together, the "management fee agreements");

- Presentations and other information provided by business and portfolio management personnel at the June 2017 Board meeting; and

- Letter from the Chairman of the Board to management requesting information related to the 15(c) approval process and corresponding responses from management.

The information listed above was generally provided as part of the Board's annual review process. I also reviewed and considered relevant information received throughout the year while participating in the quarterly Board meetings, including the investment sub-committee meetings.

D. **Board Review of Investment Advisory Agreements**

At the upcoming August 2017 Board meeting, the trustees will be asked to vote on a proposal to continue the investment advisory agreements for the Funds. The Board previously met in June 2017 to review and consider information provided by management and independent consultants, as described above. At such time, the Board's investment committees (equity, fixed income, and money market and alternative products) met to review performance and expense information for each Fund. Particular attention was paid to Funds deemed to be potential Watch List funds based on criteria established by independent counsel to the Board. Preliminary findings were identified, including a proposed list of Watch List Funds which require additional scrutiny on an ongoing basis.

As part of its review of the investment advisory agreements, the Board also reviewed Fund performance information received from management on a regular basis during the year. This includes peer group and benchmark comparisons, as well as analyses prepared by management of Fund performance. The Board has engaged Casey, Quirk & Associates, an independent consultant, to review the performance of each Fund (other than the money market Funds) at each quarterly Board meeting. In addition, management periodically provides comparative information regarding Fund expense ratios and those of the peer groups.

II. **SUMMARY OF FINDINGS AND RECOMMENDATIONS**

Summarized below are the findings of my review of the Funds' proposed management fees. In evaluating the information provided, I considered each of the specific factors enumerated in the AG Agreement. Although I weighed certain factors more heavily, no single factor was determinative.

In performing my review, I noted that the information provided by management and independent consultants was extensive, comprehensive, and well organized. I also noted that the Board's annual review process was thorough and effectively structured. In particular, I observed that the investment sub-committees provide a strong framework for reviewing Fund performance both annually and on a regular basis during the year.

A. Nature and Quality of Services

Based on my review, I believe the advisory and administrative services provided to the Funds are appropriate in nature and the quality level is high. In reaching this conclusion, I reviewed and considered the background and qualifications of the Adviser's investment personnel and the services provided to each of the Funds under the Advisory Agreement. (My review of Fund performance is included in a separate section below.) I noted the broad scope of the Adviser's investment capabilities which enable it to provide a comprehensive and innovative range of products to Fund shareholders.

I also reviewed and considered the nature and quality of the administrative services provided by J.P. Morgan Investment Management Inc. to each of the Funds under the Administration Agreement. This includes business management, vendor management, and the provision of legal and compliance services.

B. Fund Performance Compared to Other Mutual Funds

I reviewed and considered total return performance information compiled by Lipper Inc., an independent provider of investment company data. This included each Fund's ranking within a performance universe made up of funds with the same Lipper investment classification and objective ("Lipper Universe"). A summary of this performance information for each Fund is included in the Fund Dashboards that are incorporated by reference to this report. I also reviewed and considered the performance of each Fund compared to the performance of a smaller group of comparable funds selected by Lipper ("Lipper Peer Group") and the performance of each Fund as measured against its designated benchmark. This information included performance results for the one and three year periods ended December 31, 2016.

Summarized below are the findings of my performance review by asset class. I have specifically addressed any Fund which ranked in the 4th or 5th quintile for either the one or three year period compared to the Lipper Universe. I paid particular attention to any Fund that underperformed over a sustained period of time (generally three years) without demonstrating consistent improvement. Based on my review, I am recommending that the Board closely monitor the performance of five equity Funds and five fixed income Funds, as highlighted below.

1. Equity Funds – Except for the Funds noted below, the performance of each equity Fund ranked in the top three quintiles for both the one and three year period compared to the Lipper Universe. Therefore, they have consistently demonstrated satisfactory or better performance over a sustained period of time.

I noted that the performance of Large Cap Growth Fund ranked in the 5th quintile for the one year period and the 4th quintile for the three year period compared to the Lipper Universe. I also noted that the performance of Multi-Cap Market Neutral Fund, Small Cap Growth Fund, and Mid Cap Growth Fund (Class A) each ranked in the 4th quintile for both the one and three year period, and Intrepid Mid Cap Fund ranked in the 4th

quintile for each of the last two years. Therefore, these Funds have underperformed over a sustained period of time without demonstrating consistent improvement.

Recommendation: I recommend that the Board closely monitor the performance of these five Funds until improvement is demonstrated. I also recommend that the Board request the Adviser to report performance results to the Equity Investment Committee each quarter and steps taken to improve performance.

2. **Fixed Income Funds –** Except for the Funds noted below, the performance of each fixed income Fund ranked in the top three quintiles for both the one and three year period compared to the Lipper Universe. Therefore, they have consistently demonstrated satisfactory or better performance over a sustained period of time.

I noted that the performance of Treasury & Agency Fund and the Class A shares of Intermediate Tax Free Bond Fund, Short-Intermediate Municipal Bond Fund, Core Bond Fund, and Limited Duration Bond Fund ranked in the 4th or 5th quintile for both the one and three year period compared to the Lipper Universe. (I also noted that each Fund's Class I shares had performance that was below the Lipper Universe median for both the one and three year period, except for Short-Intermediate Municipal Bond Fund which was slightly above the median for the one year period and below the median for the three year period.) Therefore, these Funds have consistently underperformed over a sustained period of time without demonstrating consistent improvement.

Recommendation: I recommend that the Board closely monitor the performance of these five Funds until improvement is demonstrated. I also recommend that the Board request the Adviser to report performance results to the Fixed Income Investment Committee each quarter and steps taken to improve performance.

I also noted that the performance of the Class A shares of Ohio Municipal Bond Fund and Mortgage-Backed Securities Fund ranked in the 4th quintile for the three year period compared to the Lipper Universe but ranked in the 2nd quintile for the one year period. Therefore, these Funds demonstrated improvement in the most recent year under review.

3. **Money Market Funds –** Except for the Funds noted below, the performance of each money market Fund ranked in the top three quintiles for both the one and three year period compared to the Lipper Universe. Therefore, they have consistently demonstrated satisfactory or better performance over a sustained period of time.

I noted that the performance of Municipal Money Market Fund (Morgan Shares, Service Shares), 100% U.S. Treasury Securities Money Market Fund (Service Shares), Prime Money Market Fund (Morgan Shares), U.S. Government Money Market Fund (Service Shares), and U.S. Treasury Plus Money Market Fund (Service Shares) ranked in the 4th or 5th quintile for both the one and three year period compared to the Lipper Universe. However, in each case I observed that performance was equal to or 1 bp below the Lipper Universe median for each of the prior two years (2014 and 2015), except for the Morgan Shares of Prime Money Market Fund which was equal to (in 2014) and 2 bps below (in

2015) the Lipper Universe median. Therefore, the recent underperformance of these Funds is not indicative of their more favorable performance over the longer term.

I also noted that the performance of the Morgan Shares of 100% U.S. Treasury Securities Money Market Fund and U.S. Treasury Plus Money Market Fund ranked in the 5th quintile for the one year period compared to the Lipper Universe but ranked in the 3rd quintile for the three year period. Therefore, the recent underperformance of these Funds' Morgan Shares is not indicative of their more favorable performance over the longer term.

4. <u>Alternative Funds</u> – Except for the Fund noted below, the performance of each alternative Fund ranked in the top three quintiles for both the one and three year period compared to the Lipper Universe. Therefore, they have consistently demonstrated satisfactory or better performance over a sustained period of time.

I noted that Diversified Fund ranked in the 4th quintile for the three year period compared to the Lipper Universe but ranked in the 3rd quintile for the one year period. Therefore, this Fund demonstrated improvement in the most recent year under review.

C. <u>Management Fees Charged By Other Mutual Fund Advisers</u>

I reviewed and considered the management fee rate of each Fund compared to the fee rates of mutual funds managed by other advisers with comparable investment strategies ("Lipper Universe"). I also reviewed and considered the total expense ratio of each Fund compared to the Lipper Universe. I noted that management reviews the Funds' fee and expense structure on a regular basis and has set fee waivers and/or expense caps on most Funds. (Note: For purposes of this report, I have used the Lipper definition of "management fee" to include advisory and administrative fees, net of any fee waivers and/or expense reimbursements.)

Summarized below are the findings of my fee and expense review by asset class. I have specifically addressed any Fund whose management fee or total expenses ranked in the 4th or 5th quintile. I paid particular attention to those Funds that also underperformed over a sustained period of time. Based on my review, I believe the fees and expenses of each Fund are reasonable in light of the services provided.

1. <u>Equity Funds</u> – Except for the Funds noted below, the management fee and total expense ratio of each equity Fund ranked in the top three quintiles compared to the Lipper Universe.

I noted that the total expense ratio of Mid Cap Value Fund's Class A and Class I shares ranked in the 4th quintile compared to the Lipper Universe, and the management fee of the Fund's Class I shares ranked in the 4th quintile compared to the Lipper Universe. However, I observed that the performance of each class ranked in the 1st quintile for both the one and three year period compared to the Lipper Universe.

I also noted that the management fee of Mid Cap Growth Fund's Class I shares ranked in the 4th quintile compared to the Lipper Universe. However, I observed that the Fund's total expense ratio ranked in the 3rd quintile, and performance ranked in the 3rd quintile for the three year period compared to the Lipper Universe.

2. **<u>Fixed Income Funds</u> –** Except for the Fund noted below, the management fee and total expense ratio of each fixed income Fund ranked in the top three quintiles compared to the Lipper Universe.

I noted that the management fee of High Yield Fund's Class A and Class I shares ranked in the 4th quintile compared to the Lipper Universe. However, for each class I observed that the total expense ratio ranked in at least the 3rd quintile and performance ranked in at least the 3rd quintile for the one and three year period compared to the Lipper Universe.

3. **<u>Money Market Funds</u> –** Except for the Funds noted below, the management fee and total expense ratio of each money market Fund ranked in the top three quintiles compared to the Lipper Universe.

I noted that the management fee and total expense ratio of Municipal Money Market Fund (Morgan Shares, Service Shares), 100% U.S. Treasury Securities Money Market Fund (Morgan Shares), and U.S. Treasury Plus Money Market Fund (Morgan Shares) ranked in the 4th or 5th quintile compared to the Lipper Universe. I also noted that the total expense ratio of 100% U.S. Treasury Securities Money Market Fund (Service Shares), Liquid Assets Money Market Fund (Morgan Shares), Prime Money Market Fund (Morgan Shares), U.S. Government Money Market Fund (Morgan Shares, Service Shares), and U.S. Treasury Plus Money Market Fund (Service Shares) ranked in the 4th or 5th quintile compared to the Lipper Universe. However, in each case I observed that performance was still equal to or 1 bp below the Lipper Universe median for each of the prior two years (2014 and 2015), except for Prime Money Market Fund (Morgan Shares) which was equal to (in 2014) and 2 bps below (in 2015) the Lipper Universe median.

I also noted that the management fee of Municipal Money Market Fund's Institutional Shares ranked in the 4th quintile compared to the Lipper Universe. However, I observed that the Fund's total expense ratio ranked in the 2nd quintile, and performance ranked in the 1st or 2nd quintile for both the one and three year period compared to the Lipper Universe.

4. **<u>Alternative Funds</u>** – Except for the Funds noted below, the management fee and total expense ratio of each alternative Fund ranked in the top three quintiles compared to the Lipper Universe.

I noted that the management fee of Investor Balanced Fund and Investor Conservative Growth Fund ranked in the 4th or 5th quintile compared to the Lipper Universe. However, I observed that each Fund's total expense ratio ranked in the 2nd quintile, and performance ranked in the 2nd quintile for the three year period compared to the Lipper Universe.

D. <u>Management Fees Charged to Other Clients of the Adviser</u>

I reviewed and considered information regarding management fees charged by the Adviser to other clients with comparable investment strategies. I noted that the Adviser advises institutional and managed accounts with investment strategies similar to those of many of the Funds. I also noted that the fees paid by the Adviser's other clients are sometimes lower than the rates paid by the applicable Funds. This fee differential relates to the increased scope of services the Adviser provides to the Funds as registered investment companies. In addition, the Funds must continuously issue and redeem their shares, making the Funds more difficult to manage than institutional and managed accounts which have more stable asset levels. Given the nature and scope of the services provided to the Funds, I believe the management fees charged to the Funds are reasonable compared to those charged to other clients of the Adviser.

E. <u>Possible Economies of Scale</u>

In reviewing and considering the possible economies of scale with respect to the Funds, I noted that the advisory fee schedule under the Advisory Agreement does not include breakpoints on Fund assets above a specified level. Therefore, the Funds' advisory fee rates do not reflect economies of scale from breakpoints.

However, I did note that the administrative fee schedule under the Administration Agreement does include breakpoints which apply to each Fund based on the level of assets across the complex, as follows:

- Non-money market Funds (other than the Investor Funds) are charged 15 bps on the first $25 billion of assets under management and 7.5 bps thereafter;

- Investor Funds are charged 10 bps on the first $500 million of assets under management, 7.5 bps on the next $500 million of assets under management, and 5 bps thereafter; and

- Money market Funds are charged 10 bps on the first $100 billion of assets under management and 5 bps thereafter.

Because Fund assets exceed the breakpoint levels in each case, the administrative fees for each Fund reflect economies of scale. (The effective rate is 8 bps for non-money market Funds, 6-10 bps for Investor Funds, and 7 bps for money market Funds as of December 31, 2016.) The Lipper material defines management fees to include actual advisory and administrative fees, net of fee waivers and expense limitations. Therefore, the management fees of the Funds do reflect economies of scale due to the impact of the administrative fee breakpoints.

Finally, I noted that the Adviser has fee waivers and/or expense caps in place for most Funds that limit the total expense ratio (and the actual fees paid by the Funds) at competitive levels.

F. Costs and Profitability of Adviser and Affiliates

I reviewed information provided by management to the Board concerning the costs and profit margins of the Adviser and its affiliates related to the services they provide under the management agreements with the Funds. This includes profitability information for each Fund and for the fund complex as a whole. I also reviewed the assumptions and cost allocation methodology used in preparing this profitability information. I noted that the methodology was generally consistent with that of the prior year.

During my review, I noted the difficulty of comparing Fund profitability because comparative information is often not available and is subject to a number of factors and assumptions regarding methodology. However, based on my review of the profitability information, I believe the management fees paid to the Adviser are reasonable in light of the services provided to each Fund.

III. CONCLUSION

Based on my review and evaluation of the information provided, I believe the Board has sufficient information to conclude that the proposed management fees are reasonable and have been negotiated at arms' length in accordance with the AG Agreement. In reviewing and considering the performance of each Fund compared to the Lipper Universe, I noted that Large Cap Growth Fund, Multi-Cap Market Neutral Fund, Small Cap Growth Fund, Mid Cap Growth Fund, Intrepid Mid Cap Fund, Treasury & Agency Fund, Intermediate Tax Free Bond Fund, Short-Intermediate Municipal Bond Fund, Core Bond Fund, and Limited Duration Bond Fund have each underperformed over a sustained period of time without demonstrating consistent improvement. Therefore, I recommend that the Board closely monitor the performance of these Funds until improvement is demonstrated.