

ICI VIEWPOINTS

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## Yes, Your Fund's Board Is Watching Out for You

By Amy Lancellotta

A recent *Wall Street Journal* headline posed the question, “Is Your Fund’s Board Watching Out for You?” (June 10, 2012). The answer to the question is a resounding yes—contrary to mischaracterizations by the reporter about the role of mutual fund boards and relevant regulatory requirements.

### Mutual fund independent directors are both highly regulated and robustly independent.

Fund independent directors have a fiduciary duty to oversee the management and operations of a fund on behalf of the fund’s shareholders. In addition, the Investment Company Act of 1940—the primary federal law governing mutual funds and directors—imposes specific responsibilities on independent directors and looks to them to monitor potential conflicts of interests.

Mutual fund boards are robustly independent. The Investment Company Act sets forth specific and stringent requirements for a director to be deemed “independent.” Independent directors hold an overwhelming majority (75 percent) of board seats in over 90 percent of fund complexes, and nearly two-thirds of fund boards have an independent director serving as the board’s chair. Moreover, 97 percent of independent directors have never been employed by the fund complex.

Contrary to what the reporter indicates, mutual fund boards regularly undergo regulatory and legal scrutiny. Their role has repeatedly been strengthened and reconfirmed by the Securities and Exchange Commission through rules and regulations. In 2010, in its unanimous ruling in *Jones v. Harris*, the U.S.

Supreme Court recognized and endorsed the oversight provided by mutual fund independent directors.

## Directors provide strong oversight of fund performance and fees.

One of the board's most important responsibilities is to annually approve the fund's contract with the adviser. In contrast to the reporter's assertion, fund boards rigorously represent the interests of shareholders in reviewing and approving the contract and through ongoing communications with the adviser. Directors throughout the year assess the quality of the adviser's services, most notably the fund's performance, and can push for corrective action if necessary. Such action may include urging the adviser to hire a new portfolio manager or subadviser for the fund, to increase its investment research capability, or to close or merge the fund. In addition, directors have a variety of tools for bringing fees down, such as breakpoints at specified asset levels, fee waivers, outright fee reductions, or service enhancements.

The fact that directors typically do not "fire" the fund's adviser does not indicate that directors do not forcefully represent shareholders' interests. Such a drastic step would be costly, disruptive, and, importantly, contrary to shareholders' express intention to invest with a particular money manager. Replacing the adviser is not comparable to a corporate board replacing a CEO or top members of management at the company—it is more like replacing the company's entire operational staff.

The overall fee-setting process works, as evidenced by [declines in fund fees and expenses](#), while shareholder services have increased. And shareholders have proven themselves very sensitive to costs, as there has been a general preference by investors, [including 401\(k\) investors](#), for lower cost funds.

## Directors oversee multiple funds to the benefit of shareholders.

The unique structure of mutual funds and fund complexes make board oversight of multiple funds within a fund complex an efficient and effective approach to governance. This is because all of the funds within the same complex usually receive necessary services (including, for example, portfolio management and shareholder recordkeeping) from the same entities, are served by common personnel, and are organized around common operating features.

## Directors' compensation is transparent.

Independent directors' compensation varies within the industry and may depend on a number of factors. Differences in the complexity and size of funds and fund groups overseen by a director; the

time commitment required for meetings and other duties; the number of meetings; and the compensation levels necessary to attract highly qualified people all can play a role in determining compensation. Unlike corporate directors, mutual fund independent directors do not receive shares or options in the mutual fund. Further, placing control over compensation in the hands of the independent directors and not with fund management helps to ensure the independence and effectiveness of the board. Finally, every mutual fund is required to disclose directors' compensation in its statement of additional information (SAI).

In the United States, almost 2000 independent directors serve on mutual fund boards, working on behalf of hundreds of thousands of shareholders. They are diligent, highly regulated, and bring varied expertise to boards. Mischaracterizations of fund boards and the important work they do is a disservice to investors. For more information about directors and the work they do on behalf of shareholders, please visit the [IDC website](#).

Amy Lancellotta was Managing Director of the Independent Directors Council (IDC).

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