

IDC Letter to SEC Highlights Proper Role of Fund Boards

Letter Outlines Approach to Limiting Directors' Responsibilities Under SEC Rules to Fund Oversight

Washington, DC, June 23, 2016 - The proper governance role of fund independent directors is oversight, not management, the Independent Directors Council (IDC) said in a recent [letter to the Securities and Exchange Commission](#) (SEC) that supplements IDC's previous comments on rule proposals to regulate funds' [liquidity risk management](#) and [use of derivatives](#).

Though regulators, directors, and others generally agree that the board has an oversight role, the SEC's pending proposals are the latest indication that these parties may hold different views on what "oversight" means, IDC said. To address these differences, IDC suggested factors to consider when drawing the oversight-versus-management line. IDC also urged the SEC to hold a roundtable to promote a robust discussion and to facilitate a clear understanding among all interested parties on how best to define the fund director's role.

"If regulators do not draw the oversight-versus-management line correctly, fund governance—and, ultimately, fund shareholders—could suffer," said IDC Chair Paul Freeman, independent director of Deutsche Funds. "Inappropriate regulatory burdens could expose directors to increased liability, could reduce boards' effectiveness, cohesion and collegiality, and could limit the pool of qualified director candidates. Even incremental shifts toward management functions could lead over time to a set of inappropriate board responsibilities that would not be in shareholders' best interests and would be difficult to reverse."

IDC's letter suggests the following factors be considered when determining the types of responsibilities that could appropriately be imposed on independent directors:

- *Potential conflict of interest.* IDC agrees with the SEC's traditional approach of imposing specific responsibilities on independent directors when a matter involves a potential conflict between the interests of the fund and those of the adviser—the approach contemplated by the Investment

Company Act of 1940. The letter explains how the interests of a fund and its adviser already are generally aligned with respect to liquidity risk management and a fund's use of derivatives, and do not present conflicts that warrant independent scrutiny by a fund board.

- *Fund compliance program.* Any new regulatory requirement would be subject to the robust compliance framework for funds mandated by Rule 38a-1 of the '40 Act. Before seeking to impose specific approval responsibilities on fund directors, the SEC should consider the extent to which a fund's compliance program would address any regulatory concerns.
- *Director expertise.* Regulations that effectively require fund directors to develop deep expertise on a subject are inconsistent with the common understanding of what an oversight role entails. This issue is raised by both of the SEC proposals that IDC addresses in its letter—each would require in-depth understanding of technical matters, such as value-at-risk models or the computation of risk-based coverage amounts for complex derivatives.

IDC believes that this subject requires further public dialogue among all interested parties, and that the factors stated in IDC's letter provide an appropriate framework for such a discussion.

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete.

Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.