ICI VIEWPOINTS

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MarketWatch Misunderstands Important Role of Mutual Fund Directors

Shareholders deserve better than a recent MarketWatch column's clear misunderstanding of a mutual fund director's work. To correct just a few points:

Directors' independence: Mutual fund boards are robustly independent. Fund independent directors, as fiduciaries, are required to act in the best interest of fund shareholders. As the Supreme Court observed, independent directors have "the primary responsibility" for looking after the interests of the fund's shareholders and serve as "independent watchdogs" who "furnish an independent check" upon the management of the fund.

The Investment Company Act of 1940—the primary federal law governing mutual funds and directors—sets forth specific and stringent requirements for a director to be deemed "independent" and requires that at least 40 percent of the directors on a board be independent. In practice, independent directors hold an overwhelming majority (75 percent) of board seats in nearly 90 percent of fund complexes.

Directors' responsibilities: In contrast to the column's assertion, fund boards do push firms to do right by customers. One of the board's most important statutory responsibilities is to annually evaluate and approve the fund's contract 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, including 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.

Directors overseeing multiple funds: 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' pay: Fund directors are paid for the work they do on behalf of shareholders, and their fundamental responsibilities are constant, regardless of market fluctuations and the performance of different asset classes. 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. Moreover, directors' compensation is transparent: every mutual fund is required to disclose directors' compensation in its statement of additional information.

For more information about directors and the work they do on behalf of shareholders, please visit the IDC website.