ANNUAL REVIEW 2016

IDC
INDEPENDENT DIRECTORS COUNCIL
Committed to Strong Fund Governance

The Independent Directors Council (IDC) supports fund independent directors in fulfilling their responsibilities to promote and protect the interests of fund shareholders. Through its mission of advancing the education, communication, and policy positions of independent directors—and promoting public understanding of their role—IDC advocates for high standards of fund governance, for the benefit of funds and their shareholders. IDC also provides practical information and guidance to fund boards about important issues, helping them adapt to regulatory and industry developments.

IDC is part of the Investment Company Institute (ICI), a leading global association of regulated funds, including mutual funds, exchange-traded funds, closed-end funds, and unit investment trusts in the United States, and similar funds offered to investors in jurisdictions worldwide.

1,784

independent directors…

Oversee more than

11,000

US-registered funds…*

With more than

$18 trillion

in assets…*

And represent the interests of more than

95 million

shareholders.

* Data exclude unit investment trusts. Data for mutual funds and exchange-traded funds are as of November 2016. Data for closed-end funds are as of September 2016.

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LETTER FROM THE GOVERNING COUNCIL CHAIR

Jonathan F. Zeschin

Throughout IDC's 12-year history, our commitment to strong fund governance has been constant. But in an industry evolving so quickly, that commitment has required constant adaptation and innovation, to help fund directors prepare for and manage their responsibilities.

Our education programming has grown richer and more diverse, supplying directors with the knowledge they need to serve shareholder interests. Our events have grown more frequent, making it easier for directors to benefit from our offerings and to share ideas and experiences with their peers on other boards. And our advocacy in policy debates on behalf of directors is as strong as ever, helping shape the governance provisions in new rules.

Under the new administration, the regulatory environment could look quite different from how it has looked in the recent past. Still, the investment management business will continue to grow more complex—and the scope of independent directors' responsibilities will continue to expand—so it has never been more important for directors to be well-versed in all that the job entails. Tens of millions of fund shareholders depend on directors to be as knowledgeable and effective as possible, as soon as they set foot in the boardroom.

That's why I'm so excited about our plan to offer a new director orientation program this year. This innovative program will be a stand-alone, comprehensive education initiative designed both to prepare incoming directors for the demands of the job and to help newer directors build on what they've learned in their first years serving on fund boards. Participants will learn through a blended curriculum of in-person sessions, online modules, and written materials.

We anticipate that the number of new directors will grow in the coming years, and that this program—focusing on the fundamentals of board oversight that are common across the industry—will serve as a ready resource for directors looking to get a head start in taking on their new roles.

The program is just one example of how IDC's services will evolve in 2017. In addition, we will be holding plenty of informative events over the course of the year, including conferences, webinars, chapter meetings, and others. I encourage you to join us for as many of these events as you can. It is your contributions that make these events so useful to the fund director community.

During my service on IDC's Governing Council, I've had the privilege of engaging with hundreds of fund directors, and I am always learning more effective ways to carry out my governance duties. In the year ahead, I encourage all fund directors to take full advantage of the community that IDC has fostered. That's how we can stay informed and involved in service of our 95 million fund shareholders.

LETTER FROM THE MANAGING DIRECTOR

Amy B.R. Lancellotta

Fund governance observers will remember 2016 as a year of spirited debate on twin topics: the proper role of fund independent directors and the duties that fit with that role. The director perspective on both is straightforward, and always has been. Directors are best positioned to represent shareholder interests when they oversee the work of fund management, which takes care of the day-to-day business of running the fund.

This sharp distinction—managers manage and directors oversee—is one of the hallmarks of the fund industry's success over three-quarters of a century. Yet it has become increasingly blurred in recent years, with SEC proposals asking fund boards to take on tasks that don't line up with how directors view their job.

Last year, we saw this play out in two important rulemaking proposals drawn from the SEC's ongoing agenda for asset management: one to reform how regulated funds manage liquidity risk and another to limit how they can use derivatives. Both proposals called for oversight from fund boards—yet both also called on directors to perform duties that fall squarely in the realm of fund management.

During the rulemaking process, IDC stood firm in support of defining the appropriate role of fund boards, while preparing directors for any possible outcome. We challenged the elements of the proposals that charged directors with management functions. We hosted educational webinars that walked directors through the proposals and the responsibilities that they would impose on fund boards if implemented. And we held panel sessions at our most popular events that looked in-depth at how the new responsibilities could redefine a board's role and relationship vis-à-vis the fund's adviser.

This debate has shown us something: it's essential that the SEC and the fund industry work toward a common understanding of the types of responsibilities that make sense for an oversight role and those that make sense for fund management. To that end, we suggested that the Commission use three factors as a starting point when thinking about imposing new regulatory responsibilities on directors:

» whether there is a potential conflict of interest that warrants independent scrutiny by a fund board;

» whether a fund's compliance program already addresses any regulatory concerns and, if so, the extent that it does; and

» whether directors would be expected to develop deep expertise in a subject area inconsistent with the prevailing, long-held view of what an oversight role entails.

We are pleased that the Commission's final liquidity risk management rule incorporated many of the recommendations put forward by IDC and others, and hope for a similar outcome in any final derivatives rule.

Thanks to our talented staff and Governing Council, we'll always be well-prepared to advocate for a clear line between oversight and management. The future of fund governance—and, ultimately, the success of fund shareholders—depends on it.

Amy Lancellotta

EDUCATION—BUILDING DIRECTOR EXPERTISE

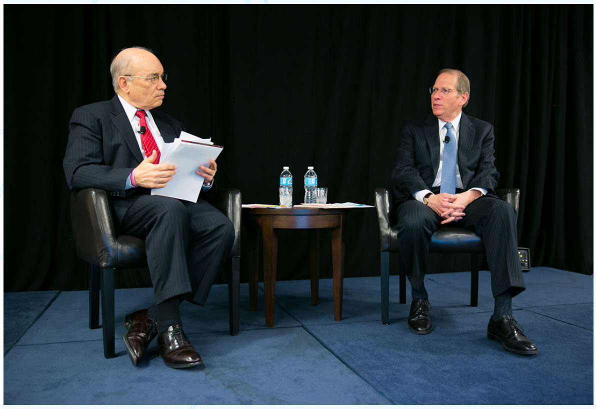
To fulfill their oversight responsibilities and fiduciary duties, fund directors must have a wide range of knowledge—not only about governance practices, but also about the latest regulatory, judicial, and industry developments. By providing both formal and informal learning opportunities, IDC helps directors acquire and continually build this knowledge as the industry evolves.

Learning and Networking Abound at Annual Events

Annual events are a key component of IDC's work to educate fund directors. Each fall at the Fund Directors Conference in Chicago and each spring at the Fund Directors Workshop in Washington, DC, the fund director community convenes to hear from seasoned board members, industry leaders, board and litigation counsel, and others, while networking with peers from across the country.

At the 2016 Fund Directors Conference, the discourse was dominated by changes that will occur as a result of the SEC's liquidity risk management rule and the US Department of Labor's fiduciary rule. Other informative sessions focused on political and economic pressures around the globe and their effect on the fund industry, the use of financial technology in asset management, Section 36(b) cases, the role of the board in responding to crises, and more.

At the 2016 Fund Directors Workshop, directors began the day at a roundtable discussion over breakfast, where they shared ideas about governance practices, liquidity risk management, and cybersecurity. Workshop attendees also learned about methodologies for portfolio performance analyses, and about trends in the format and content of reports provided to fund boards. Rounding out the event were panels on fund directors' priorities, considerations for building an effective board, and the implications of the SEC's regulatory agenda on directors' oversight role.



Ralph Verni, independent director of Eaton Vance Funds, and Barry Barbash, partner at Willkie Farr & Gallagher LLP, lead a discussion on fund directors' priorities at IDC's Fund Directors Workshop.

Fund directors share perspectives on governance practices at IDC's Fund Directors Conference.

Timely and Informative Webinars

IDC's broad webinar lineup, a core component of its web-based educational offerings, keeps directors informed on the latest governance and regulatory issues. In 2016, IDC held seven webinars:

- an analysis of SEC staff guidance on fund distribution and subaccounting fees stemming from the Commission's "distribution in guise" sweep examinations, along with insight on what the guidance means for board oversight practices;
- an overview of the SEC's proposed derivatives rule and the responsibilities it will impose on fund boards, if adopted;
- a discussion of the US Department of Labor's final fiduciary rule and its potential impact on fund distribution models;
- an update on fund industry litigation, SEC enforcement activity, and financial protections provided for funds and fund directors by indemnification and D&O/E&O insurance;
- an update for directors of money market funds on the industry's implementation of the SEC's 2014 money market fund reforms, including board considerations for fees and gates and for scenario planning;
- an in-depth look at subadviser selection and oversight at Vanguard, providing insight into the company's manager-of-managers business, its due diligence process, and the role of the board; and
- a report on the court's decision in favor of AXA Equitable in its "excessive fee" litigation, and the implications of the decision for the advisory contract approval process and the role of fund directors.

A Deep Cache of Resources

At www.idc.org, directors can access a deep cache of educational materials. The new Resources for Directors page, for example, hosts a wealth of information organized by category, offering practical guidance and insight on governance, oversight of fund operations, litigation and regulatory matters, and oversight of portfolio management.

Visit IDC's Resources for Directors page at www.idc.org/idc/resources.

- Webinar archives, publications, comment letters, FAQs, third-party resources, and more—all organized by topic in one convenient place.
- User-friendly index and glossary, enabling directors to quickly find what they're looking for or explore important topics in greater detail.
- New content added regularly.

In addition, IDC's website highlights upcoming events and hosts archives of *Board Update*, an e-newsletter covering IDC events and activities, recent industry developments, and regulatory and litigation news, among other topics. Directors also can access ICI resources from the website, including fund industry data and research, comment letters, *ICI Viewpoints* blog posts, and *ICI Daily*, a digest of top fund industry news.

Fund Governance: A Successful, Evolving Model

In spring 2016, the *Virginia Law & Business Review* published an article examining why the unique system of governance outlined in the Investment Company Act of 1940, though sometimes overlooked, has been one of the most important factors in the fund industry's tremendous growth.

Coauthored by IDC Managing Director Amy Lancellotta, ICI President and CEO Paul Schott Stevens, and Ropes & Gray partner Paulita Pike, the educational piece tells the story of how fund governance has evolved over nearly a century, and looks ahead to today's regulatory environment and how it could affect fund governance in the coming years.

To read the article, visit **www.ici.org/uva**.

OUTREACH—FACILITATING DIRECTOR ENGAGEMENT

One of the most important ways that fund directors build knowledge and skills is by engaging with peers who serve on other fund boards. IDC brings directors together, enabling them to exchange ideas on governance practices, discuss what they've learned from past experiences, and share perspective on the latest regulatory and industry developments.

Regional Chapter Meetings

IDC's chapter meetings promote meaningful dialogue—not just on issues affecting fund directors, but also on issues affecting the industry overall. Held in nine locations across the country and by conference call (see map on page 7), these informal gatherings—free of charge to directors of ICI member funds—offer a valuable opportunity for directors to have candid discussions about the governance practices followed by boards and to learn from one another. The meetings attract both newer and experienced directors and provide IDC with valuable insight on how to structure its programs in a way that best supports directors' evolving needs.

In 2016, IDC's chapter meetings featured presentations from industry experts to supplement the discussion among directors. Presentation topics included the advisory contract renewal process, cybersecurity, trends in fund industry claims, oversight of liquidity risk management, the state of global markets, business continuity and transition planning, blockchain technology, valuation, and more.

Industry Segment Conference Calls

Industry segment conference calls offer directors the opportunity to participate in discussions that are tailored to their specific board roles, and that focus on the issues they face in those roles. IDC held eight of these calls in 2016—two each for directors of small fund complexes, governance committee chairs, audit committee chairs, and board leaders. Learn more about the calls on page 7.

Board Meetings

IDC and ICI host meetings for boards of ICI member funds at ICI's state-of-the-art facilities, where both IDC and ICI staff are available to discuss governance issues and update boards about industry and regulatory news. The Washington, DC, location of the facilities, which include a boardroom that seats 70, promotes attendance by regulators and members of Congress. At the request of individual fund boards, IDC and ICI staff also travel to participate in board meetings in other locations. In 2016, IDC and ICI hosted five board meetings, while IDC and ICI staff participated in 10 others.

The Value of IDC's Industry Segment Conference Calls, Explained by the Directors Who Lead Them

Directors of Small Fund Complexes

When it comes to governance practices or regulatory challenges, board members from smaller fund complexes have a unique perspective. On our conference calls, we appreciate having the opportunity to converse with directors who come at these issues from a similar vantage point, and to share how boards approach them.

Steve Paggioli, independent director of AMG Funds and Professionally Managed Portfolios

Governance Committee Chairs

On our calls with governance committee chairs, we usually talk shop about tools and processes for identifying qualified board candidates, recruiting effective directors, and putting together a good committee charter. The merits of mandatory retirement policies often come up, too. From each call, my colleagues take away new ideas to bring to their own boards. The same is true for me.

Tom Lemke, independent director of AXA Premier VIP Trust, JP Morgan ETF Trust, and SEI Funds

Audit Committee Chairs

Whether we are getting together by phone or meeting in person at IDC's Fund Directors Conference, the audit committee chairs are a collegial group. The group helps develop our agendas, which cover everything from regulatory guidance to audit quality, auditor independence, fund accounting and reporting, and valuation. The wide-ranging perspectives are useful in addressing the challenges facing audit committees.

Garry Moody, audit committee chair of AB Funds

Board Leaders

Independent board chairs and lead independent directors have a lot on their plates—interacting with management, building an effective board, crafting board meeting agendas, and making the most of executive sessions, for example. The board leaders calling into our discussions contribute insightful observations on these issues and others, and offer useful tips that enlighten us all.

Ralph Verni, independent director of Eaton Vance Funds

IDC's Chapter Meetings in 2016*

* IDC held a chapter meeting for directors based in Arizona and Texas by conference call.

ADVOCACY—SHARING THE DIRECTOR PERSPECTIVE

It is critical that fund directors have a voice in the policy debates that could affect the way they serve the interests of fund shareholders. In 2016, as regulators in the United States and abroad proposed, considered, and finalized a number of rulemakings with provisions for fund governance, IDC worked to ensure that these rulemakings took the unique and important perspective of directors into account.

Liquidity Risk Management and Derivatives

Much of IDC's advocacy in 2016 centered on two SEC proposals: one on liquidity risk management and one on funds' use of derivatives. As IDC noted in separate comment letters on the proposals, the SEC expressed the view that the role of directors is one of oversight, but the specific requirements of the proposals inappropriately burdened directors with responsibilities that are better suited to fund management.

» **Liquidity risk management.** IDC supported a requirement for funds to formally adopt a liquidity risk management program overseen by their boards, but asked the SEC to clarify that boards would not be tasked with determining the liquidity of any security, and to clarify that directors' oversight of the program would be no different than their oversight of other areas of portfolio management and fund operations. IDC also urged that any Commission evaluation of board actions in overseeing the program should be based on a "reasonable business judgment" standard.

» **Derivatives.** IDC backed the SEC's call for boards to oversee funds' use of derivatives, but recommended modifications to ensure that board responsibilities are consistent with an oversight role. IDC also sought changes to ensure that other requirements in the proposal do not obligate boards to carry out management functions or ask them to engage in deeper analysis than an oversight role allows.

As the SEC considered comments on these proposals, IDC wrote a supplemental letter to the Commission expressing the need for a common understanding of the types of responsibilities that fit with directors' conventional oversight role, and the types that should be reserved for fund management. The letter also urged the Commission to hold a roundtable on how best to determine where regulatory responsibilities should fall.

Thanks to the advocacy of IDC and others, the Commission's final liquidity risk management rule included substantial changes consistent with IDC's recommendations. The SEC has not taken final action on the derivatives proposal.

A Word from the Policy Steering Committee Chair

Steve Paggioli

IDC's policy steering committee shapes all of IDC's policy positions, and ensures that the director perspective is communicated to policymakers. In 2016, with the SEC's agenda for asset management front and center, we found ourselves busier than ever. For example, after the Commission proposed its liquidity risk management rule, we repeatedly and forcefully voiced our concern that many of the responsibilities imposed on fund directors by the proposal drew them too far into the work of fund management.

We're pleased that the final rule heeded our concern, and look forward to continuing our advocacy on behalf of directors in the year ahead.

Online Delivery of Shareholder Reports

The SEC's 2015 proposal to modernize fund reporting included a rule to let funds post shareholder reports online as the default means of delivery. In 2016, IDC wrote a supplemental comment letter urging the Commission to adopt the online delivery rule, explaining that it would save shareholders hundreds of millions of dollars while aligning with their growing preference to access financial information online.

To fully realize the cost savings, the New York Stock Exchange (NYSE) needed to amend its fee schedule governing shareholder report delivery for broker-held accounts. IDC supported the NYSE's proposal to make the necessary changes, and the SEC subsequently approved them. Although the proposed online delivery rule did not make the final fund reporting package, IDC will continue to encourage the SEC to adopt this important initiative.

Transfer Agent Rules and Broker-Dealer Disclosure

Responding to an SEC concept release seeking public comment on issues associated with its ongoing review of transfer agent rules, IDC emphasized that requiring intermediaries to provide funds with meaningful information about their services would enhance board oversight of funds' intermediary relationships. IDC opposed any disclosure requirement that would reveal the specific fee arrangement between a fund and a transfer agent, arguing that this information is proprietary and that disclosing it could interfere with the fund's ability to negotiate the best terms.

Meanwhile, an SEC proposal requiring broker-dealers to disclose more information about how they route customer orders earned IDC's full support. If adopted, the proposal will help funds assess broker-dealers' order-routing practices, enable funds to trade more efficiently, and strengthen board oversight of funds' brokerage allocation practices—all for the benefit of fund shareholders.

The Auditor's Report

In a comment letter filed jointly with ICI on a Public Company Accounting Oversight Board (PCAOB) reproposal to change the auditor's report, IDC applauded the PCAOB's decision to exclude audits of registered funds from a requirement to include a description of "critical audit matters"—a decision recommended by IDC and ICI in comments on the PCAOB's initial proposal from 2013. Because funds are pools of assets managed according to specified investment mandates, and because of the disclosures they already provide in their prospectuses and shareholder reports, this information would provide little, if any, benefit to shareholders.

The letter expressed concern, however, that the PCAOB's proposed requirement to disclose auditor tenure in the auditor's report could imply a relationship between auditor tenure and audit quality. Instead, IDC recommended, tenure should be disclosed on a form filed with the PCAOB.

Fund Governance Abroad

When the Central Bank of Ireland (CBI) proposed a new "location rule" to restrict the residency of fund management companies' directors and key managers, IDC and ICI Global pushed back in a joint response. The response contended that the proposed rule—designed to ensure that the CBI has adequate access to the key managers, directors, and records of fund management companies—could needlessly disqualify top board candidates and hinder efforts to enhance cross-border fund business.

The CBI's final rule did impose residency requirements, though they are somewhat less stringent than those outlined in the proposal.

Shortening the Settlement Cycle

For the past several years, the fund industry has worked with other market participants to shorten settlement cycles for a range of securities from three business days after the trade date (T+3) to two business days after the trade date (T+2). An important component of the effort is an SEC rule amendment, which the SEC proposed in the fall. IDC expressed strong support for the amendment, noting that the benefits of a shorter settlement cycle—including reduced operational and counterparty risks, enhanced liquidity, and improved process efficiencies for market participants—would flow to funds and their shareholders.

GOVERNING COUNCIL MEMBERS

As of January 1, 2017

Jonathan F. Zeschin*
Governing Council Chair
Independent Director, Matthews Asia Funds

Paul K. Freeman*
Governing Council Chair Emeritus
Independent Director, Deutsche Funds

Julie Allecta
Independent Director, Salient Funds

Ashok N. Bakhru*
Independent Director, Goldman Sachs Funds

Kathleen T. Barr
Independent Director, William Blair Funds

Dorothy A. Berry*
Independent Director, PNC Funds and Professionally Managed Portfolios

Donald C. Burke
Independent Director, Duff & Phelps Funds

Gale K. Caruso
Independent Director, Pacific Life Funds and Matthews Asia Funds

David H. Chow
Independent Director, Market Vectors ETF Trust

William R. Ebsworth
Independent Director, Wells Fargo Funds

Susan C. Gause
Independent Director, HSBC Funds and MetLife Funds

George J. Gorman
Independent Director, Eaton Vance Funds

Keith F. Hartstein
Independent Director, Prudential Retail Funds

Cynthia Hostetler
Independent Director, Aberdeen Investment Funds

Leonade D. Jones
Independent Director, American Funds

John P. Kavanaugh
Independent Director, MFS Funds

Marie L. Knowles*
Independent Director, Fidelity Fixed Income and AssetAllocation Funds

Thomas P. Lemke
Independent Director, AXA Premier VIP Trust, JP Morgan Exchange-Traded Fund Trust, and SEI Funds

Joseph Mauriello
Independent Director, Fidelity Equity and High Income Funds

Joanne Pace
Independent Director, OppenheimerFunds

Steven J. Paggioli*
Independent Director, AMG Funds and Professionally Managed Portfolios

Sheryl K. Pressler
Independent Director, Voya Funds

Erik R. Sirri*
Independent Director, Natixis & Loomis Sayles Funds

Laura T. Starks*
Independent Director, TIAA-CREF Funds

Ronald E. Toupin, Jr.
Independent Director, Guggenheim Funds

Ralph F. Verni*
Independent Director, Eaton Vance Funds

Dawn M. Vroegop
Independent Director, MetLife Funds and Driehaus Funds

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* On ICI Board of Governors

IDC STAFF

Amy B.R. Lancellotta

Annette Capretta

Lisa Chaikin Hamman

Managing Director

Amy B.R. Lancellotta has been IDC's managing director since 2006. For 17 years before taking this position, she worked in ICI's Law Department, serving most recently as senior counsel. Before joining ICI, Amy worked in private practice, focusing on issues relating to investment companies and variable insurance products. She is a graduate of the Pennsylvania State University and the George Washington University National Law Center.

Deputy Managing Director

Annette Capretta joined IDC in 2006 from the US Securities and Exchange Commission, where she served in various capacities in the Office of Risk Assessment, the Division of Investment Management, and the Division of Enforcement. Annette also previously served as vice president and senior counsel at Charles Schwab. She earned a BS from the University of North Carolina and a JD from the University of Virginia School of Law.

Senior Associate Counsel

Before joining IDC in 2004, Lisa Chaikin Hamman worked at Morgan, Lewis & Bockius LLP, counseling investment advisers and investment companies, and their boards of directors or trustees, on federal regulatory matters. Lisa began her fund industry career in the legal department at Fidelity Investments. She earned a BA from the University of Michigan and a JD from Suffolk University Law School.

2016 ACTIVITIES

Comment Letters

Liquidity Risk Management Programs; Swing Pricing (January, SEC)

Use of Derivatives by Registered Investment Companies and Business Development Companies (March, SEC)

Transfer Agent Regulations (April, SEC)

Supplemental Comments on Investment Company Reporting Modernization (May, SEC)

Supplemental Comments on Liquidity Risk Management and Funds' Use of Derivatives Proposals (June, SEC)

Proposed Auditing Standard on the Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion (August, PCAOB)*

Fund Management Company Effectiveness—Third Consultation (August, Central Bank of Ireland)**

Notice of Filing of Proposed Rule Change Adopting Maximum Fees Member Organizations May Charge in Connection with the Distribution of Investment Company Shareholder Reports Pursuant to Any Electronic Delivery Rules Adopted by the Securities and Exchange Commission (September, SEC)

Disclosure of Order Handling Information (September, SEC)

Amendment to Securities Transaction Settlement Cycle (December, SEC)

Webinars

SEC Staff Guidance on Mutual Fund Distribution and Subaccounting Fees: A Summary and Discussion for Fund Directors (February)

SEC Proposal on Funds' Use of Derivatives (February)

DOL Fiduciary Rule: Overview for Fund Directors (May)

Fund Industry Litigation, SEC Enforcement, and Director Insurance (June)

Money Market Fund Reform Implementation: An Update for Fund Directors (July)

Subadviser Selection and Oversight: A Discussion About Vanguard's Approach (July)

AXA Equitable's Section 36(b) Victory (September)

Industry Segment Conference Calls

Directors of Small Fund Complexes (April, September)

Governance Committee Chairs (May, October)

Audit Committee Chairs (May, October)

Board Leaders (June, October)

Conferences

Fund Directors Workshop (May)

Independent Counsel Roundtable (July)

Fund Directors Conference (October)

Chapter Meetings

Palm Beach Gardens (February)

Denver (March)

Texas and Arizona, held by conference call (March)

Boston (April, October)

Washington, DC (April)

Philadelphia (April, September)

Chicago (April, September)

New York (May, October)

Los Angeles (June)

San Francisco (June)

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* Filed jointly with ICI

** Filed jointly with ICI Global