

# Overview of Fund Governance Practices, 1994–2018

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## Key Findings

- » **Fund boards, as a group, follow strong governance practices to best serve the interests of shareholders.** Studies of board practices indicate that, over time, fund boards have adopted such practices in advance of, or in the absence of, any regulatory mandate to do so.
- » **Independent directors make up three-quarters of boards in 84 percent of fund complexes.** Between 1996 and 2018, the number of complexes reporting that independent directors hold 75 percent or more of board seats rose from 46 percent to 84 percent. Current SEC rules require only that funds relying on common exemptive rules have boards with a majority of independent directors.
- » **Approximately two-thirds of fund complexes report having an independent chair. Sixty-six percent of complexes reported having boards with independent chairs at year-end 2018.** When complexes that have boards with lead independent directors are also considered, 91 percent of participating complexes report having an independent director in board leadership at year-end 2018.
- » **Almost all complexes report that separate legal counsel serve their independent directors.** The total percentage of complexes reporting that independent directors are represented either by dedicated counsel or by counsel separate from the adviser's has increased over the past decade, from 64 percent in 1998 to 95 percent at year-end 2018. More than half of complexes say that their independent directors retain dedicated counsel—separate from both fund counsel and the adviser's counsel.
- » **Most complexes have mandatory retirement policies.** At year-end 2018, 68 percent of complexes have an age-based mandatory retirement policy, 4 percent of complexes have a mandatory retirement policy that entails both a mandatory retirement age and a limit on the number of years a director may serve, and 1 percent of complexes limit the number of years a director may serve. For those complexes with an age-based mandatory retirement policy, the average mandatory retirement age is 75. For complexes with a limit on the number of years a director may serve, the average limit is 16 years.

## Background

Fund boards perform an important role in the oversight of the fund industry. The Investment Company Act of 1940 (1940 Act) and its related rules impose significant responsibilities on fund boards and dictate elements of board structures and practices. Fund governance practices have evolved, and, in 1995, the Investment Company Institute (ICI) began to document those practices by collecting data from fund complexes biennially.<sup>1</sup> The Independent Directors Council (IDC) was formed in 2004, and, since then, the studies have been conducted jointly by ICI and IDC.

This overview provides common fund governance practices covering the period from 1994 through 2018 and is an update to the overview published two years ago.<sup>2</sup> Though the complexes participating in each biennial study have varied over the years—and some fluctuations in the data may be attributable to those variances—an examination of the data reveals certain trends. To put these data in context, this overview includes information on fund assets managed by complexes that participated in each of the biennial studies, the average fund assets served per director, the average number of funds served, and selected independent director characteristics.

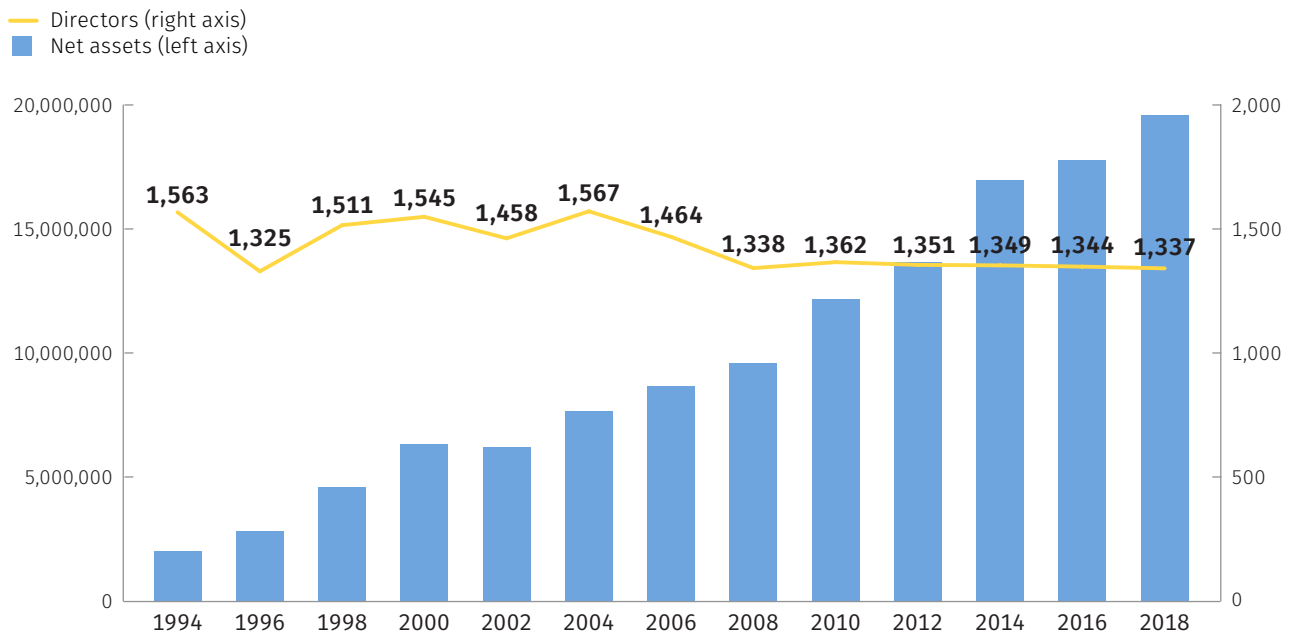
## Fund Net Assets and Independent Directors at Participating Complexes

This overview presents data on the aggregate fund net assets of complexes participating in each of the biennial studies. This overview also presents the aggregate number of independent directors at these complexes. It should be noted that the number and identity of complexes participating in the studies change over time (Figure 1).

FIGURE 1

### Total Net Assets and Total Independent Directors at Participating Complexes

Millions of dollars, 1994–2018



## Fund Net Assets and Funds Served by Independent Directors

Average fund net assets served by independent directors have increased in each of the studies conducted over the 24-year period (Figure 2). The average number of funds served has increased over time, but remained relatively stable over the past few years (Figure 3).

FIGURE 2

### Net Assets Served by Independent Directors

Millions of dollars, 1994–2018

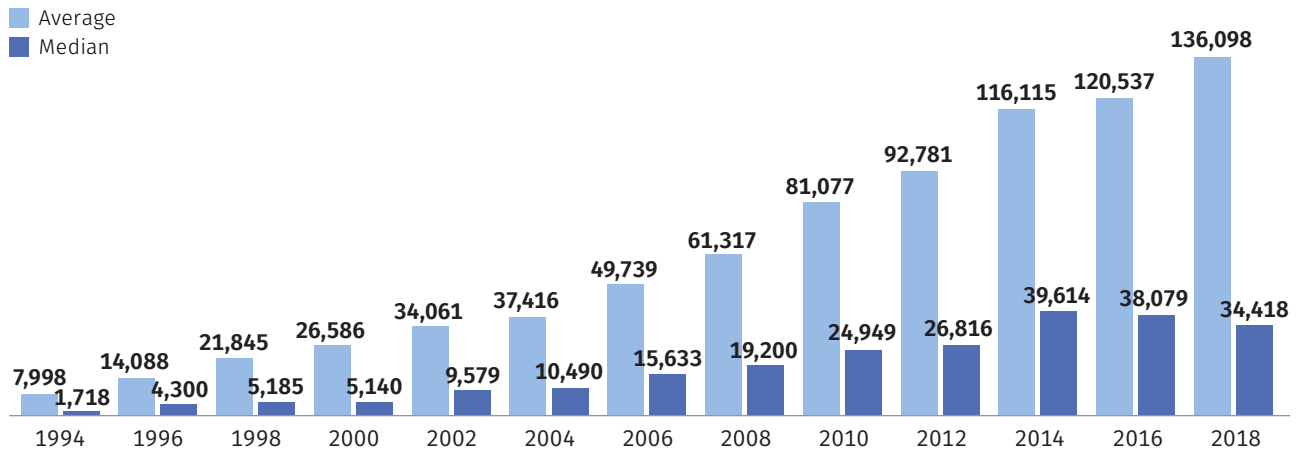
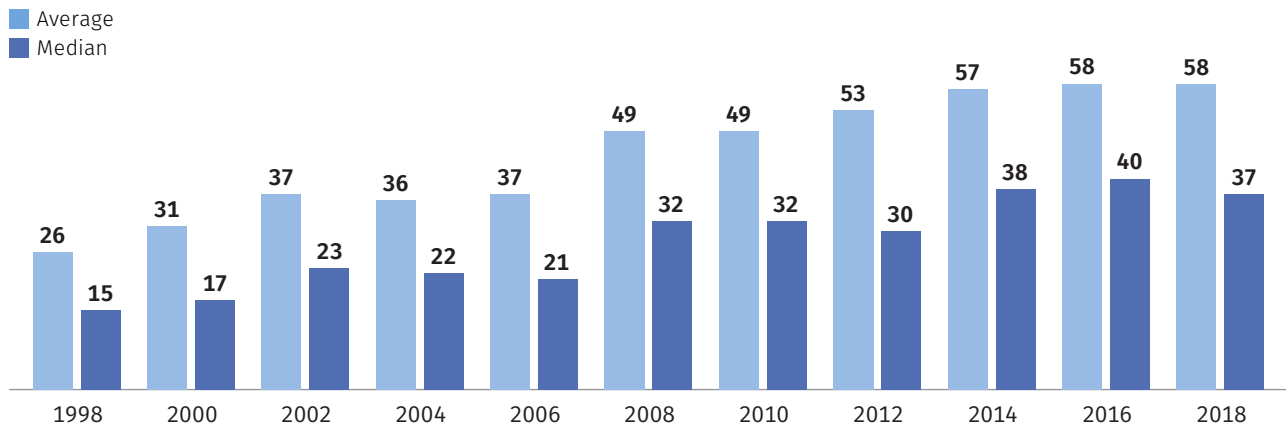


FIGURE 3

### Funds Served by Independent Directors

Number of funds, 1998–2018



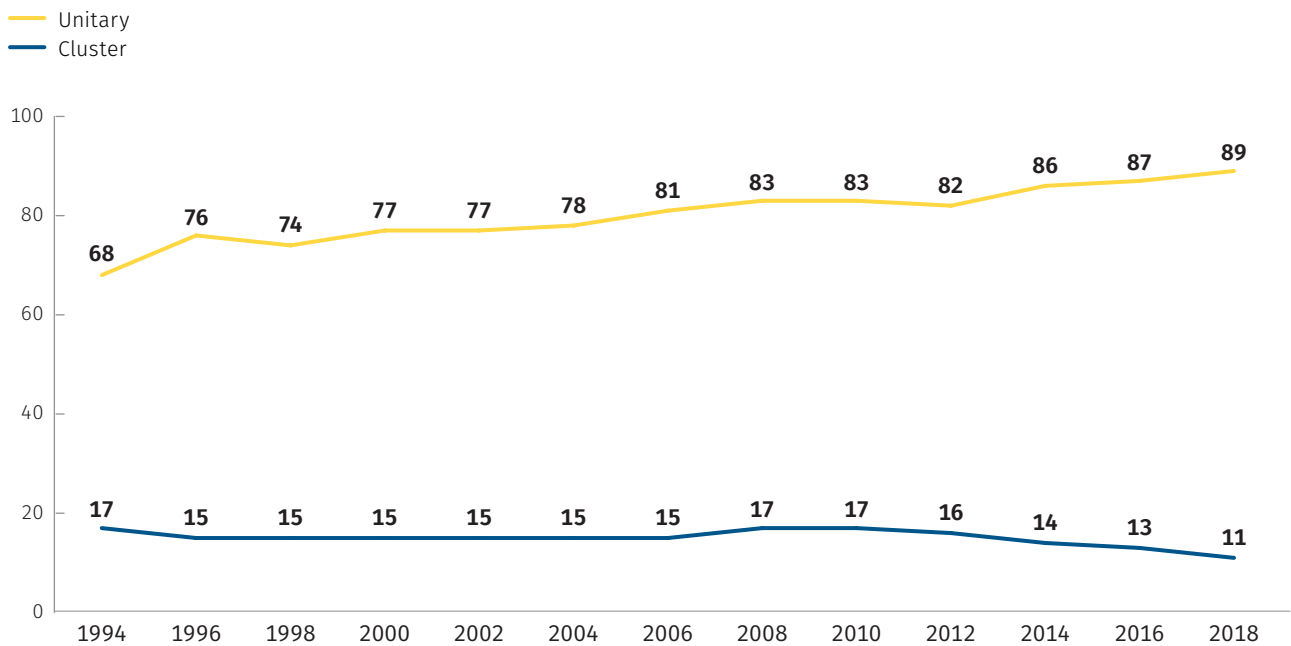
## Board Structure: Unitary or Cluster Boards

Since 1994, most complexes have employed a unitary board structure, meaning that a single board oversees all funds in the complex. As of 2018, 89 percent of participating complexes have a unitary board structure (Figure 4). Some complexes, particularly large ones, have adopted a cluster structure, where there are several boards within the complex, each overseeing a designated group of funds. The number and makeup of the clusters may be determined by several factors, including the type of funds (e.g., exchange-traded funds) or whether the funds in a particular cluster were acquired by the complex as a group. The percentage of participating fund complexes using the cluster structure over the last 24 years has declined slightly from around 17 to 11 percent (Figure 4).

FIGURE 4

### Board Structure

Percentage of fund complexes, 1994–2018



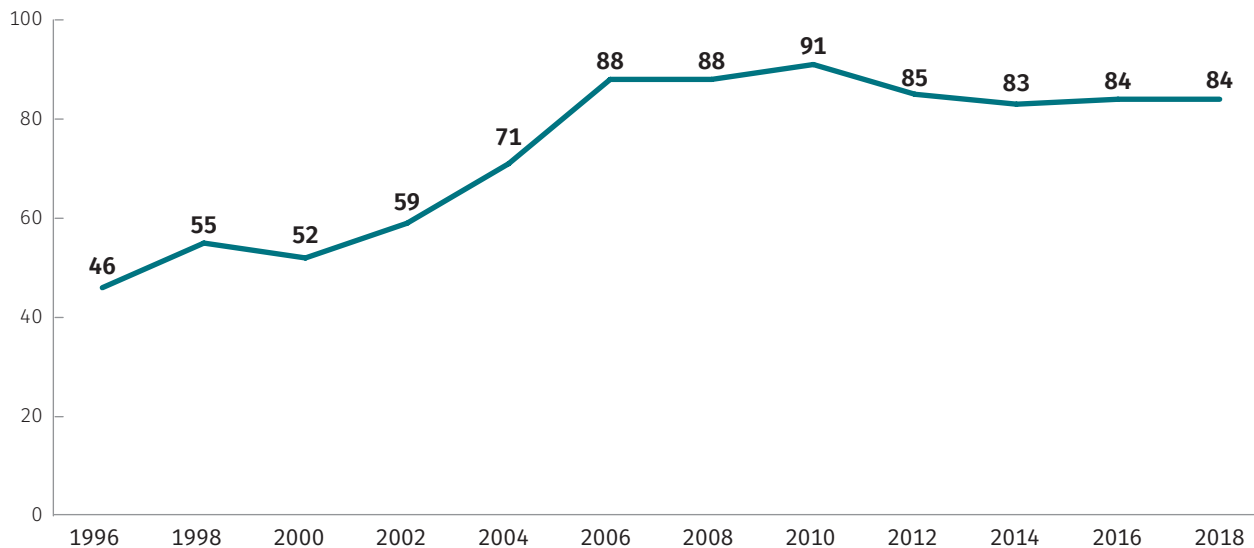
## Complexes in Which 75 Percent or More of Board Seats Are Held by Independent Directors

Over the years, these studies have collected information on the number of independent directors relative to the total number of directors at a fund complex. Under the 1940 Act, independent directors—directors who are not “interested persons” of the fund under the Act—must constitute at least 40 percent of each board unless special circumstances (e.g., following a merger) dictate a higher percentage. SEC rules adopted in 2001 mandated a majority of independent directors.<sup>3</sup> Then, in 2004, SEC rules increased the required percentage to 75 percent independent directors on each board,<sup>4</sup> although that mandate was subsequently invalidated by a federal appeals court.<sup>5</sup> In 2004, the number of complexes with 75 percent of board seats held by independent directors increased to 71 percent, likely in response to attention from regulators. By 2006, the vast majority (88 percent) of complexes reported that 75 percent or more of the board seats at the complex were held by independent directors. In recent years, the number of complexes with a board composition of at least 75 percent independent directors has remained relatively stable (Figure 5).

FIGURE 5

### Complexes Where 75 Percent or More of Board Seats Are Held by Independent Directors

Percentage of complexes, 1996–2018





## Number of Independent Directors per Complex and per Board

The number of independent directors in a given complex is influenced by the total number of directors on the board and the number of fund boards at the complex. The average number of independent directors per complex has remained relatively stable over the course of the 24-year period. The median number has ranged from five to seven over the same period (Figure 6). In 2008, the study began reporting the number of independent directors per board (in addition to the number per complex). Since that time, the median and average number of independent directors per board generally has been six (Figure 7).

FIGURE 6

### Independent Directors per Complex

1994–2018

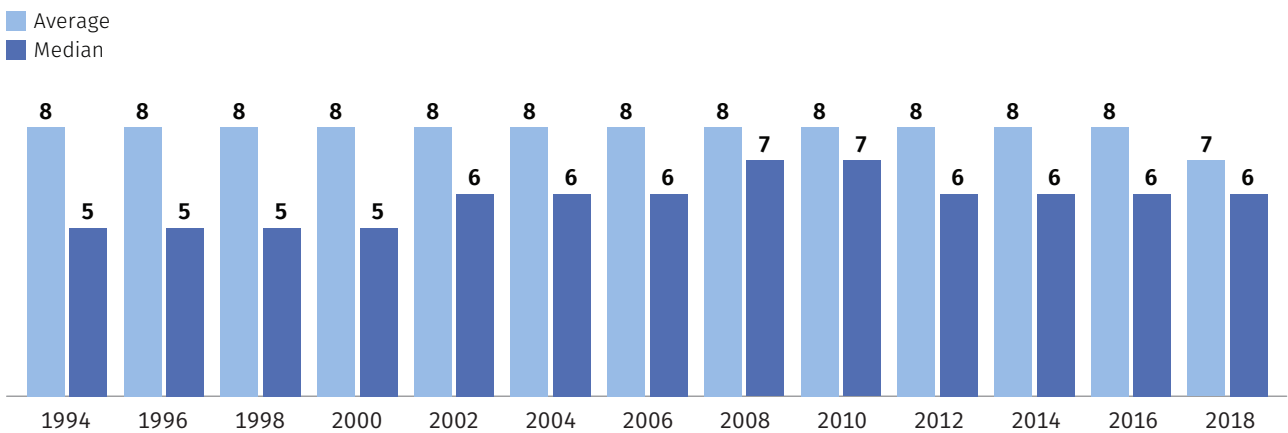
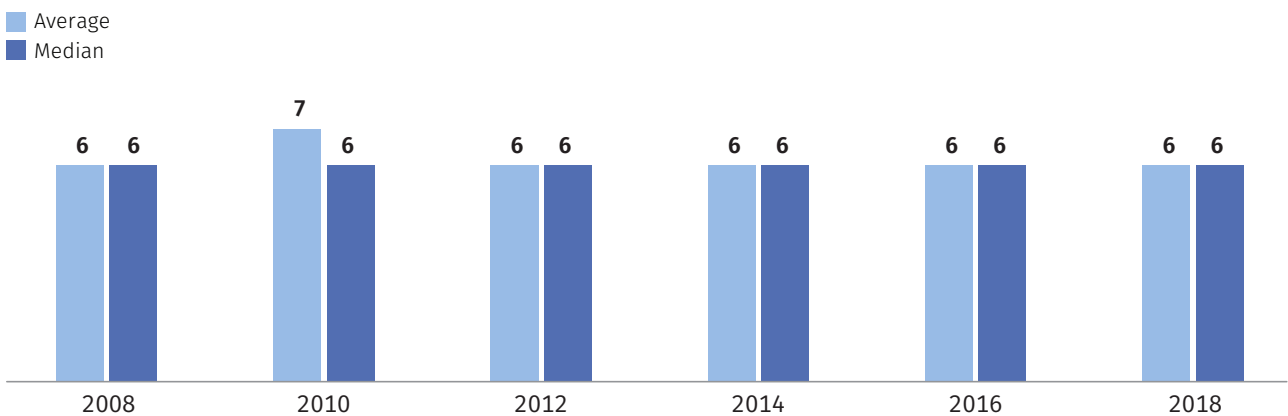


FIGURE 7

### Independent Directors per Board

2008–2018



## Frequency of Board Meetings

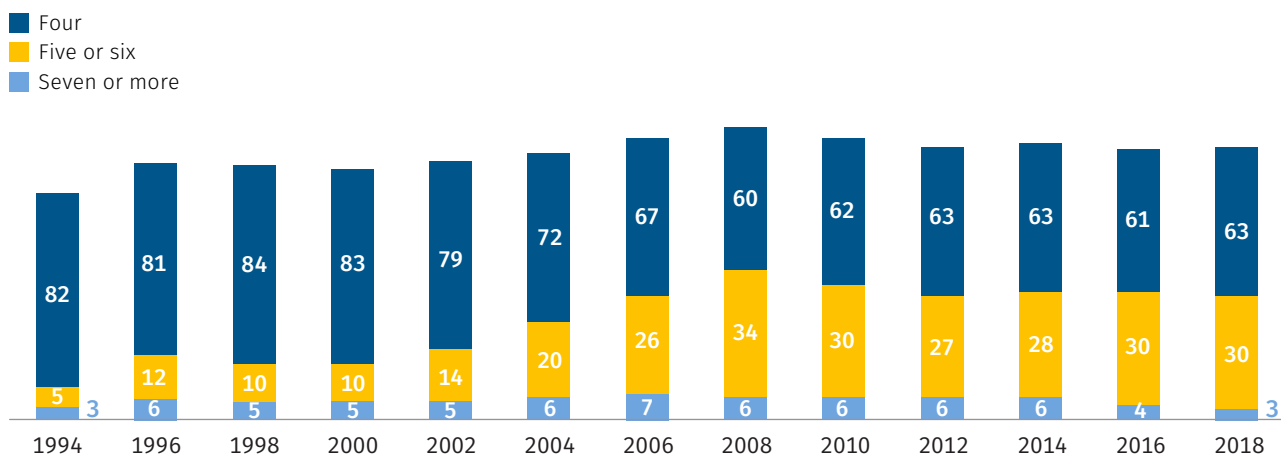
The frequency of regularly scheduled board meetings is not dictated by statute or rule. Approval of the advisory contract, among other duties, must occur annually at an in-person meeting, but the timing, length, and nature (e.g., in person, telephonic) of the other meetings are matters to be determined by each board. The decision on the frequency of meetings may be influenced by several factors, including the size of the board and the number of funds the board oversees. A board may also elect to meet less frequently but for more days each time. One-third of participating complexes indicate that they held five or more regularly scheduled in-person board meetings in 2018 (Figure 8).

In practice, fund directors often meet more frequently than called for by their regular schedule. Additional in-person or telephonic meetings are held, if necessary, to address specific issues.

FIGURE 8

### Regularly Scheduled In-Person Board Meetings per Year

Percentage of complexes, 1994–2018



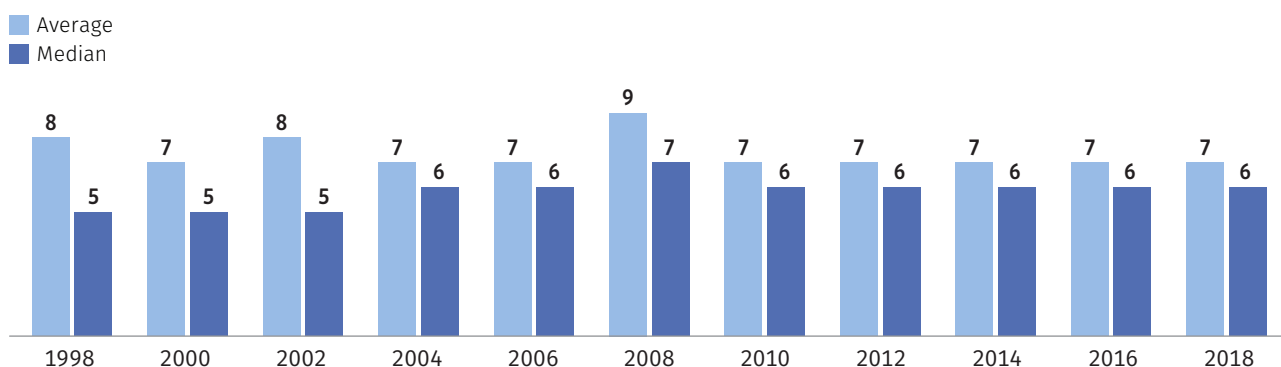
## Board Meetings and Committee Meetings in Which Independent Directors Participated

As noted, a board's regularly scheduled meetings may be augmented by nonscheduled or impromptu meetings. For that reason, since 1998, the studies have included information on the number of board meetings in which independent directors actually participated, either by phone or in person. Between 1998 and 2006, the number of board meetings averaged between seven and eight per year, increased to nine in 2008 (likely due to the turbulent market environment), and subsequently returned to seven per year (Figure 9).

FIGURE 9

### Board Meetings in Which Independent Directors Participated

1998–2018

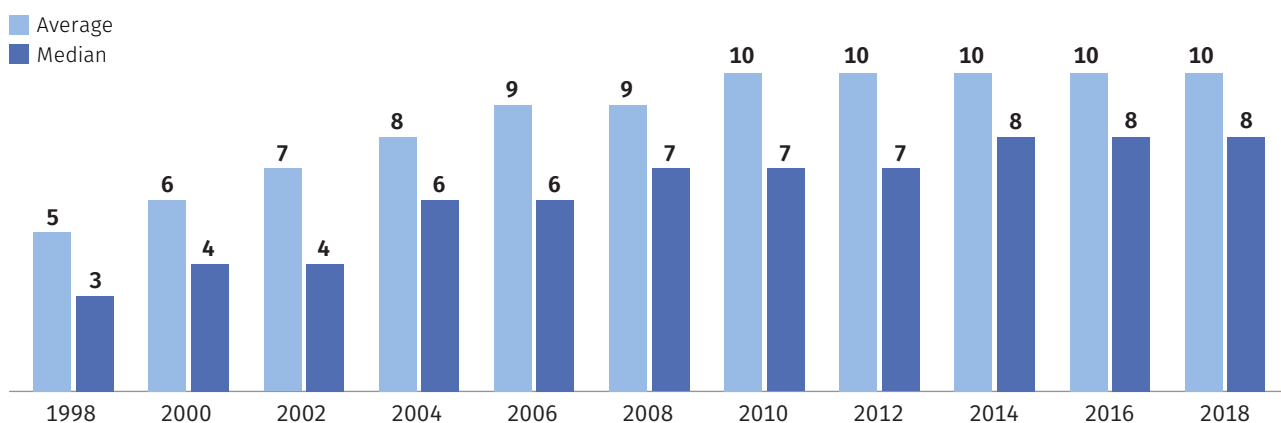


Quite often, committee meetings are held in conjunction with regularly scheduled board meetings. If necessary to accomplish their respective missions, committees may hold additional meetings. In addition, independent directors may serve on multiple committees. Over the past several years, the average number of committee meetings in which independent directors participated has remained steady at 10 (Figure 10).

FIGURE 10

### Committee Meetings in Which Independent Directors Participated

1998–2018



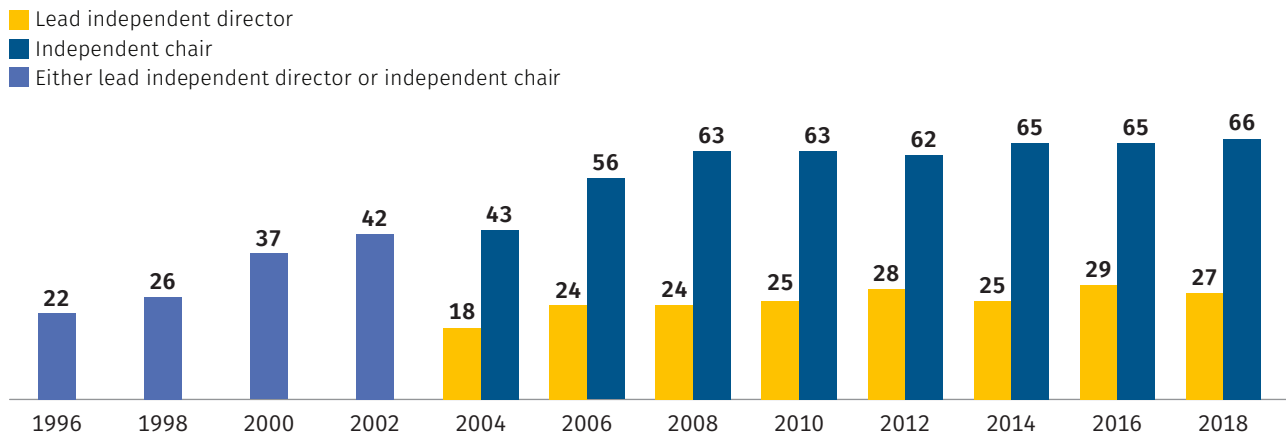
## Independent Chair or Lead Independent Director

Practices relating to independent fund board leadership vary greatly. Some boards elect an independent chair, while other boards designate an independent director to serve as the primary liaison between independent directors and the adviser. Still other boards do not have an independent chair or a lead independent director. Beginning in 1996, survey participants were asked if they had either an independent chair or a lead independent director, but they were not asked to distinguish between the two. The 2004 study, for the first time in the series, collected data separately on the incidence of independent chairs and lead independent directors.<sup>6</sup> In 2018, two-thirds of the participating complexes reported that they have an independent chair. As of year-end 2018, 91 percent of participating complexes reported having an independent chair or a lead independent director (Figure 11).<sup>7</sup>

FIGURE 11

### Complexes with an Independent Chair or Lead Independent Director

Percentage of complexes, 1996–2018



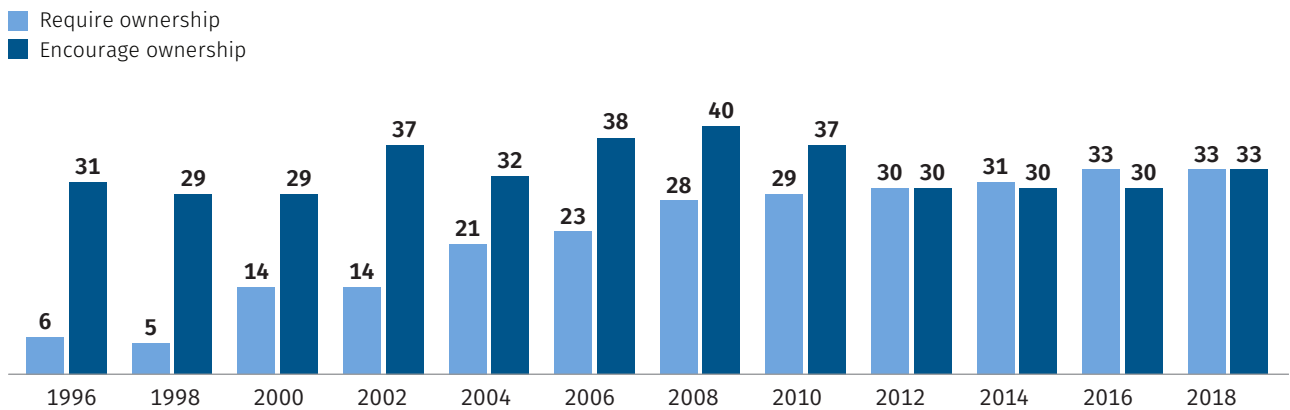
## Independent Director Fund Share Ownership

Though many independent directors choose to own shares of the funds they oversee, the practice is not routinely required. This issue attracts some attention because SEC rules require disclosure of fund share ownership by directors. The data indicate that the number of complexes formally requiring fund share ownership by independent directors has increased steadily since 1996 (Figure 12). As of year-end 2018, 33 percent of participating complexes reported that they have a formal policy requiring such fund share ownership. The segment of complexes encouraging, as opposed to requiring, ownership of fund shares climbed to 33 percent in 2018.

FIGURE 12

### Share Ownership by Independent Directors

Percentage of complexes, 1996–2018



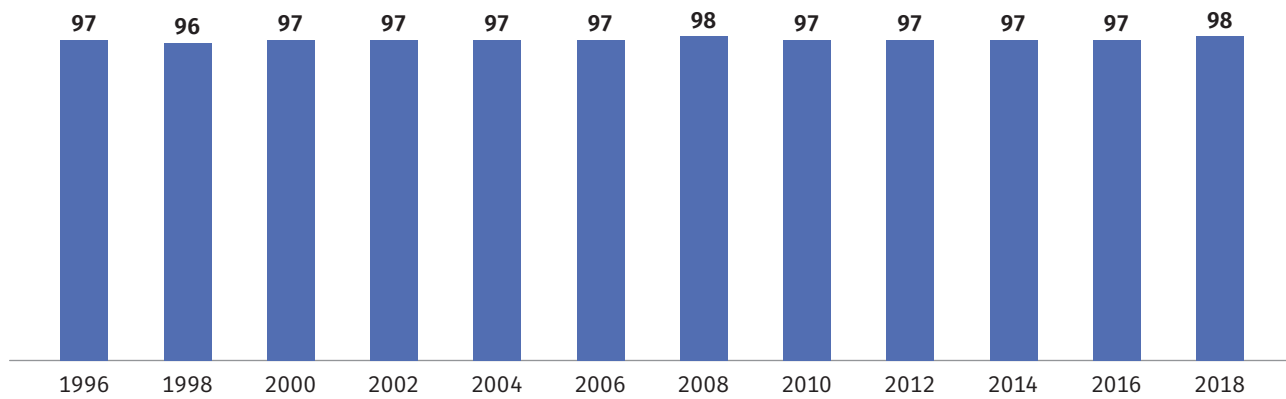
## Independent Directors' Prior Affiliation with Complex

The 1940 Act provides that an individual is an “interested person” if he or she has certain personal, financial, or professional relationships with the fund, investment adviser, or principal underwriter. The SEC may also issue an order finding that a director who has had a material business or professional relationship with the fund, adviser, or principal underwriter within the past two fiscal years is an interested person.<sup>8</sup> The studies reflect an appreciation for the letter and spirit of the law, as 98 percent of independent directors surveyed report never having been previously employed by the complex (Figure 13).

FIGURE 13

### Independent Directors Never Previously Employed by Complex

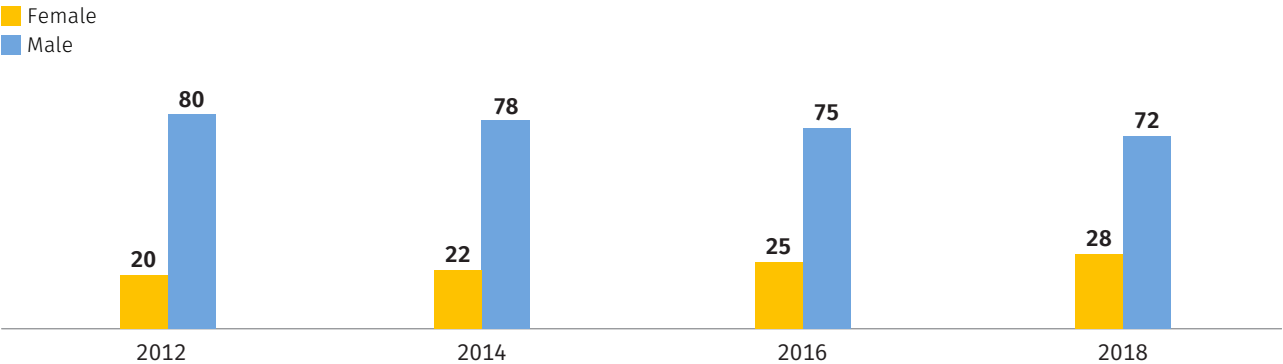
Percentage of directors, 1996–2018



# Gender Diversity

Gender diversity—and meaningful participation by female directors in the boardroom—has received increased scrutiny in recent years and is the goal of many boards, including fund boards. In 2012, the study began reporting on the gender composition of fund independent directors. The percentage of female directors has steadily increased from 20 percent in 2012 to 28 percent in 2018 (Figure 14).

FIGURE 14  
**Gender Diversity**  
Percentage of directors, 2012–2018



## Mandatory Retirement Policy

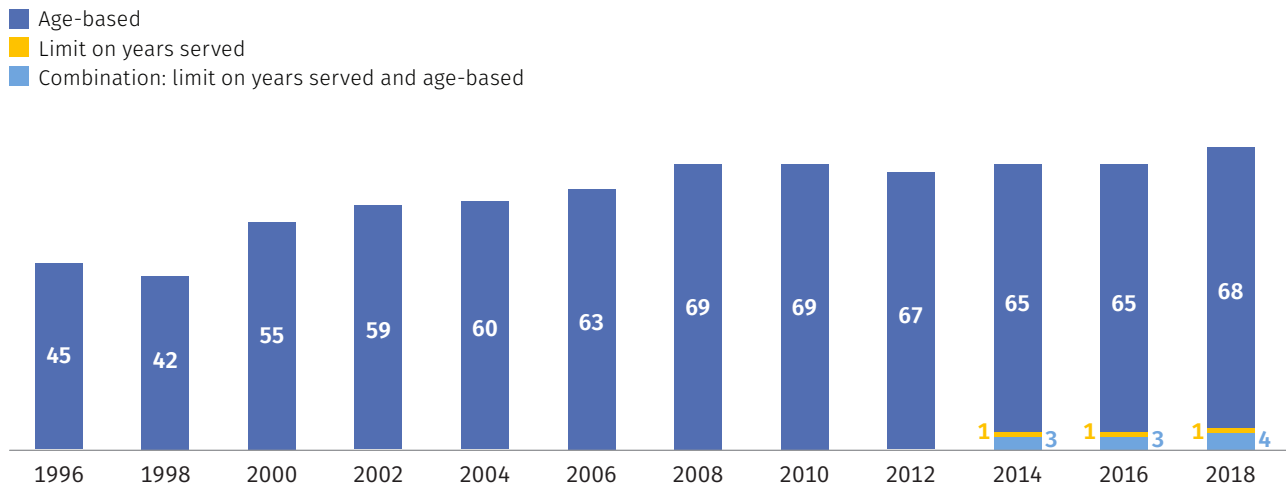
No regulatory requirement relating to retirement policies exists for fund directors, but the topic may be addressed in a board's annual self-assessment. The study has collected data on age-based mandatory retirement policies since 1996. In total, the percentage of complexes that have formally adopted mandatory retirement policies has increased gradually and stood at 73 percent in 2018.

Beginning in 2014, the study collected data on different types of mandatory retirement policies. At year-end 2018, 68 percent of complexes have an age-based mandatory retirement policy, 4 percent of complexes have a mandatory retirement policy that entails both a mandatory retirement age and a limit on the number of years a director may serve, and 1 percent of complexes limit the number of years a director may serve (Figure 15).

FIGURE 15

### Mandatory Retirement Policy

Percentage of complexes, 1996–2018



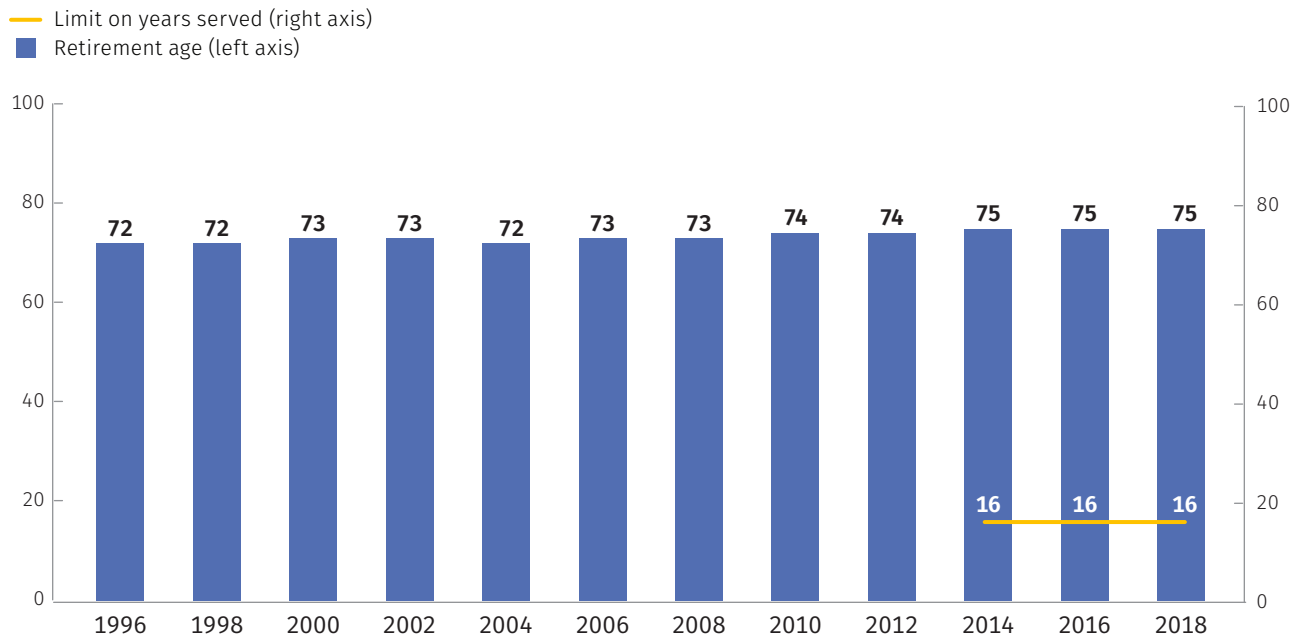
For those complexes with an age-based mandatory retirement policy, the average mandatory retirement age has increased slowly from 72 in 1996 to 75 in 2018. For complexes with a limit on the number of years a director may serve, the average limit is 16 years (Figure 16).



FIGURE 16

**Average Mandatory Retirement Age and Average Limit on Years Served**

1996–2018



To help put a director’s average retirement age in context, previous studies included the age of all independent directors participating in each biennial study and the number of years they had served their complexes as directors. Since 1996, the average age has edged up from 62 to 67 (Figure 17), and the average number of years of service has increased from nine to 12 years (Figure 18).

FIGURE 17

**Average Age of Independent Directors**

1996–2018

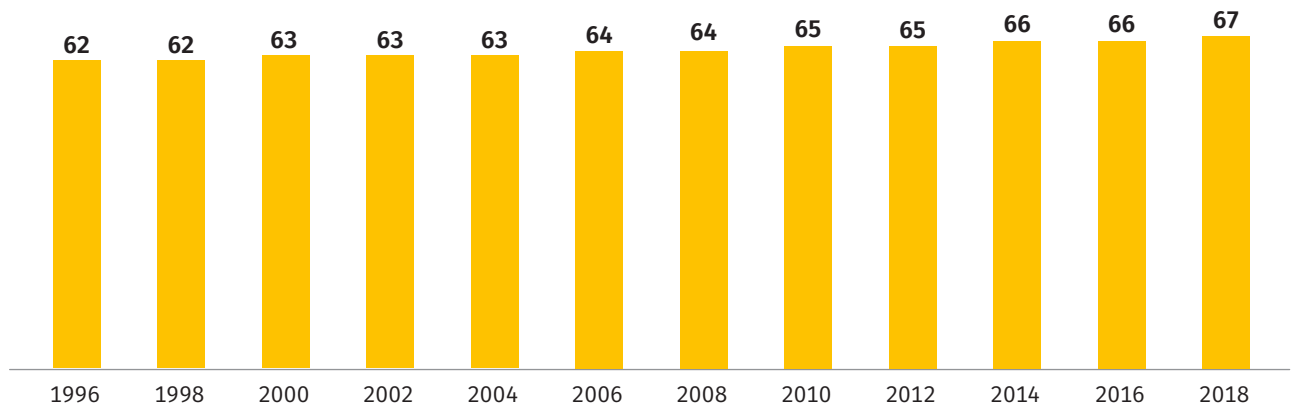
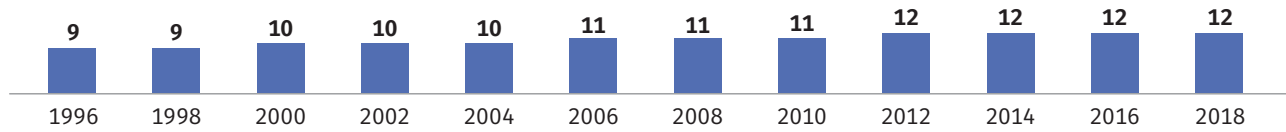


FIGURE 18

### Average Length of Service at Complex by Independent Directors

Number of years, 1996–2018



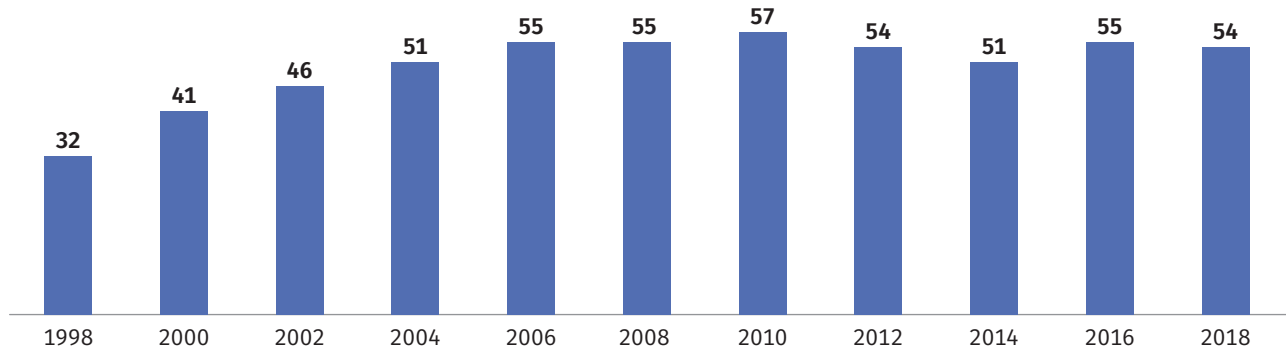
### Independent Counsel

Fund boards employ a variety of arrangements in retaining counsel. Some independent directors have their own dedicated counsel, others formally retain counsel with the fund, and still others have no dedicated counsel but instead rely on counsel to the fund (or retain other counsel) on an as-needed basis. The studies have collected data concerning director retention of counsel, and, though the form of the query in the survey questionnaire has varied, certain trends emerge. The data show that instances in which independent directors retain their own counsel—separate from fund counsel and the adviser’s counsel—have increased from 32 percent of participating complexes in 1998 to 54 percent in 2018 (Figure 19). These instances include arrangements in which the fund, adviser, and directors are served by different counsel, as well as arrangements in which the fund and adviser share counsel, but the independent directors have separate, dedicated counsel.

FIGURE 19

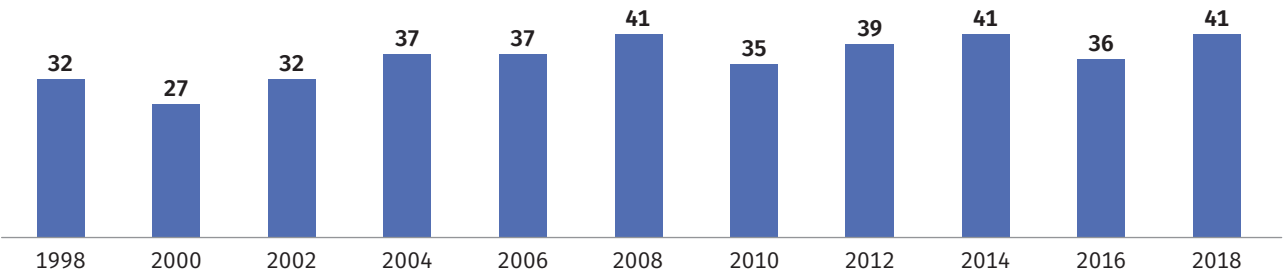
### Independent Directors Have Dedicated Counsel

Percentage of complexes, 1998–2018



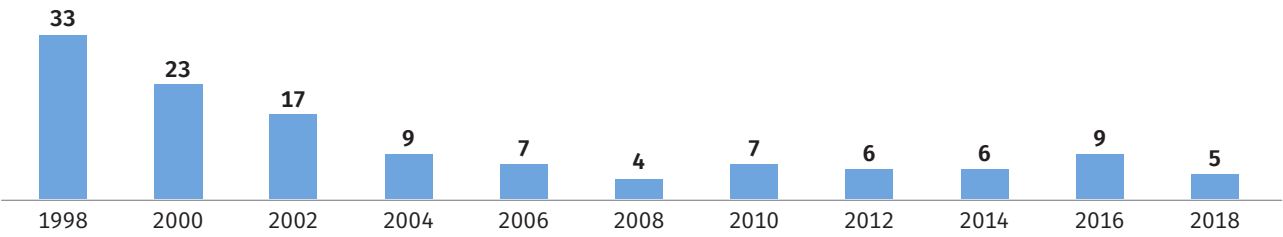
In instances where independent directors formally or informally rely on counsel to the fund while the adviser is served by different counsel, the fund counsel would constitute “independent legal counsel,” as defined by SEC rule. In 2018, 41 percent of the complexes reported that independent directors rely on fund counsel (Figure 20). Given the amount of regulatory compliance matters addressed by fund boards, such representation is beneficial to both the independent directors and the shareholders they represent.

**FIGURE 20**  
**Independent Directors Rely on Fund Counsel (Different from Adviser’s Counsel)**  
Percentage of complexes, 1998–2018



The percentage of complexes indicating that independent directors are not represented by counsel—and are not formally or informally relying on counsel to the fund—declined sharply after 1998 and has held relatively steady since 2004 (Figure 21).

**FIGURE 21**  
**Same Counsel Represents Fund and Adviser: Independent Directors Have No Separate Counsel**  
Percentage of complexes, 1998–2018



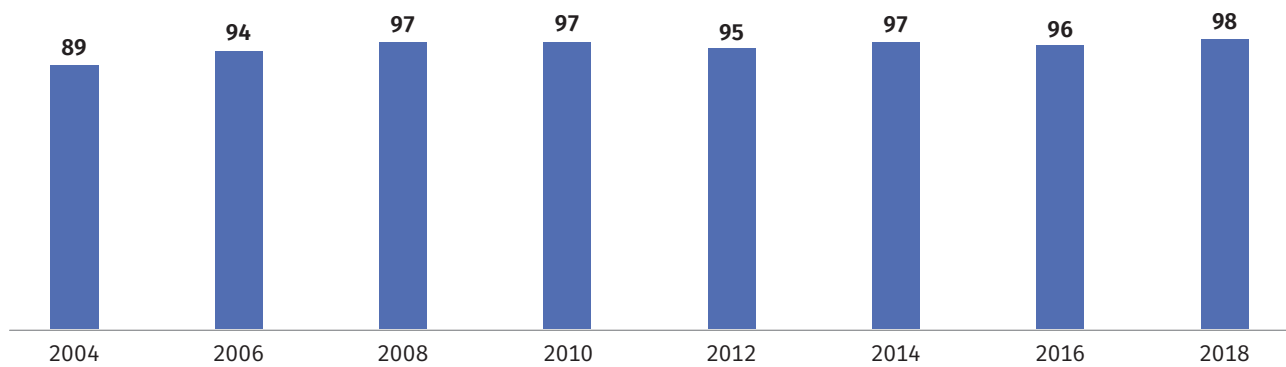
## Audit Committee Financial Expert

SEC rules require funds to disclose whether they have at least one financial expert serving on the audit committee of the board and, if so, the name of the expert and whether the expert is independent of management. Funds that do not have an audit committee financial expert must disclose the reasons why.<sup>9</sup> The studies collect data on whether complexes have an audit committee financial expert and find that virtually all (98 percent) complexes have a financial expert serving on an audit committee, notwithstanding that they are not required to do so (Figure 22).

FIGURE 22

### Complexes with Audit Committee Financial Expert

Percentage of complexes, 2004–2018



## Conclusion

Fund governance practices have continued to evolve in response to emerging industry standards and often well in advance of, or in the absence of, explicit regulatory requirements. ICI and IDC will continue to document these and other trends in fund governance practices through their studies and will publish updated overviews every two years in conjunction with the biennial collection of data.

## Notes

- <sup>1</sup> ICI and IDC collect data on board practices from participating fund complexes through the *Directors Practices Study: Practices and Compensation*. The first such study, conducted in 1995, collected data covering the year ended December 31, 1994, and 4,048 funds were represented. Subsequent studies covered 1996 (5,191 funds), 1998 (6,452 funds), 2000 (7,740 funds), 2002 (8,073 funds), 2004 (7,549 funds), 2006 (7,764 funds), 2008 (7,690 funds), 2010 (7,756 funds), 2012 (8,235 funds), 2014 (8,841 funds), 2016 (9,119 funds), and 2018 (8,940 funds). This overview will use the term “studies” to refer to all of the biennial studies collectively; results that are unique to a particular study will be identified by year.
- <sup>2</sup> ICI and IDC, *Overview of Fund Governance Practices, 1994–2016*.
- <sup>3</sup> Securities and Exchange Commission, Investment Company Act Release No. 24816 (January 2, 2001) (adopting rule amendments focused on board governance requirements of independent directors for funds relying on certain exemptive rules) (“2001 SEC Rules”). Most funds rely on at least one of the exemptive rules. Accordingly, this overview discusses the governance requirements as generally applying to all funds.
- <sup>4</sup> Securities and Exchange Commission, Investment Company Act Release No. 26520 (July 27, 2004) (“2004 SEC Rules”).
- <sup>5</sup> *Chamber of Commerce v. Securities and Exchange Commission*, 443 F.3d 890 (DC Cir. 2006). The SEC subsequently sought additional comment on the invalidated fund governance rules but then took no further action.
- <sup>6</sup> The 2004 study distinguished between independent chairs and lead independent directors because the 2004 SEC Rules mandated an independent chair, *supra* note 4. The Independent chair mandate was later invalidated by a federal appeals court, *supra* note 5.
- <sup>7</sup> Certain complexes with cluster boards have an independent chair and a lead independent director and are included in both measures in Figure 11. Accordingly, the percentage of complexes having either an independent chair or a lead independent director is less than the sum of these two measures.
- <sup>8</sup> Under Section 2(a)(19) of the 1940 Act, the SEC also may issue an order finding a person who had a material or professional relationship with the principal executive officer of the fund, investment adviser, or principal underwriter; with any other fund having the same investment adviser, principal underwriter, or the principal executive officer of such fund; or with any controlling person of the investment adviser or principal underwriter, within the past two fiscal years, to be an interested person.
- <sup>9</sup> Securities and Exchange Commission, Investment Company Act Release No. 25914 (January 27, 2003).





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