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What You'll Find Here

So you were asked, some time ago or just recently, to serve as an independent director of a mutual fund—or more likely a number of mutual funds in a fund group. Quite a compliment; whoever asked you clearly had a high regard for your judgment and integrity.

You may already have been serving for years, or you may be just deciding whether to accept the invitation to serve. Either way, you must have, or have had, plenty of questions. Like

- What exactly do they expect of me?
- How much time and effort does it take?
- Who are all these people?
- What's the potential for conflict and discord?
- What do I get paid?
- What is my exposure?

If you want to do your job on a mutual fund board of directors right, you'll need some frank answers to these questions.

A Pinch of Tension

Actually, you will discover that it is not a simple role. There may be times when you find that the challenges of being an independent director are subtle and difficult, onerous, or downright frightening.

Not too surprisingly, mutual funds are organized and run by people in the business of making a profit from organizing and

running mutual funds. Those people are the mutual fund management industry.

Each mutual fund is supervised by a board of directors that is responsible to the fund's shareholders. Broadly speaking, the independent directors on the fund's board monitor and oversee—act as a control and check on—the people organizing and running the fund—the fund's management. The U.S. Congress, the federal courts, and the Securities and Exchange Commission have all referred to a mutual fund's independent directors as “watchdogs”.

One possible problem for you is that much of the information and advice an independent director receives on how to be an independent director comes either from the mutual fund management industry itself or from lawyers who depend on the industry for a living. You are almost certain to run across two excellent booklets that fall into this category: *Introductory Guide for Investment Company Directors* (1995), published by the Investment Company Institute (the trade association for the mutual fund management industry), and *The Fund Director's Guidebook* (1996), published by the Section of Business Law of the American Bar Association.

Those publications and other presentations by management and fund lawyers tend to be pretty spare, focussing on the letter of the law and the generalities of what is required from you. They are accurate and straightforward but do not help you to understand the potential pressures of your service or what it really feels like at a fund board meeting—particularly if the going gets a little tough.

Recently the SEC also has made efforts to emphasize the importance of mutual fund independent directors and to characterize directors' responsibilities to shareholders. A series of public statements of concern by SEC representatives has led to a stream of reports, recommendations, proposed rules, and other discussion, all aimed at improving the independence, influence, and effectiveness of independent directors. But the practical impact of those issuances on how directors should

actually be doing their jobs is not always clear.

We want to fill those gaps and to give you another viewpoint against which to check what you're being told by management, the SEC, and others. This book seeks to provide practical information and useful suggestions for the mutual fund director. We try to give you a feel for what service as an independent director is really like.

You and your fund's management are not invariably adversaries and should not view yourselves as such. On the other hand, you and the management may not always find yourselves completely on the same team either. The nature of the mutual fund business and the reach of the federal regulatory framework combine to produce an unavoidable but healthy tension between a fund's management and its independent directors when the relationship is going right and, sometimes, outright conflict when it goes wrong. The point of this book is to try to help you keep that relationship at your funds constructive, productive for the shareholders, and respectful and cordial among the participants.

Our Approach

We take the approach that, regardless of the ideal of the law, you are not a saintly knight on a white horse. We view you as an intelligent and experienced human being who is anxious to do a good job for your funds' shareholders but who also has a legitimate interest in your own welfare and in protecting yourself from loss or embarrassment. As an independent director, what are you responsible for, what are you entitled to, and what should you be alert for?

Organization of the Book

The book starts with an overview of the fund business—a picture of the overall framework and how it got that way. It takes a look at the typical mutual fund and then at fund groups. It also seeks to explain coherently how money is made in the fund business.

Next we take up your responsibilities as an independent director of a fund. We first look at the history of abuse in the 1920's and 1930's that led to the legislation known as the Investment Company Act of 1940 and to Congress's making the independent director a centerpiece of the legal framework that seeks to protect mutual fund shareholders. We then discuss a number of broad considerations you should keep in mind during your service and suggest an overall approach to thinking about what you should and should not be doing for your constituent the shareholder.

We turn next to the independent directors' responsibilities for the core purpose of a mutual fund—investing. After considering the investment function, several chapters describe the other accountabilities that you have as an independent director.

We then move to the procedures and processes of a fund board of directors. What are the standards for organizing a board? What are board meetings like? How should you be contributing?

Next we take up what you can expect in terms of pay and benefits. Then we go into the extent of your exposure to personal liability from service as an independent fund director.

We wrap up with some general observations on serving as an independent director. Throughout the book we hazard guidelines for thinking about your responsibilities, management performance, and the information you need to do your job.

Style

The book's focus is always on your role and on what you should be doing. We try to stay very practical. We ignore many wrinkles of mutual fund law and operations that may be absorbing to fund managers and lawyers but are not essential to you as an independent director.

We have tried to write the book in plain, conversational English and to avoid legalese. We also occasionally use boxes to highlight important features of a subject.

The text is not cluttered with citations to laws and regula-

tions. In case you or your lawyer should have an interest, however, we include some of that information at chapter ends under the heading “Legal References”.

We have also tried not to clutter up the text with constant cross-references to other parts of the book. Occasionally we provide a lead to another chapter, but basically we hope that whenever you have a specific interest, you will take advantage of the book’s index.

Focus is on Open-End Funds

Our focus here is the role of independent directors (sometimes also called independent trustees) for open-end funds—mutual funds. The open-end fund is the vehicle accounting for over 90% of the managed investment fund industry. We do, however, devote one chapter to some of the additional considerations that an independent director of a closed-end fund should have in mind.