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Industry Dynamics Drive Fund Board Compensation Higher; 5% at Larger Fund Complexes

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Management Practice Inc. (MPI) has just completed its 18th annual "Survey of Mutual Fund Director/Trustee Compensation and Governance Practices", with data covering 1,971 directors from 374 fund families. Full reports and specific board compensation comparisons are available from MPI.

Year-over-year (equivalent director) compensation increased an average of 2.8% in 2010 over 2009 levels. Boards at larger fund families, however, saw an increase of nearly 5%. A few factors played a role in these increases. Many boards, still sensitive to the effects of the economic crisis, have kept pay flat; others have taken pay increases, some of which have been 10% or more. This is due to a few primary influences. Industry changes, including new products, complex investments, wider distribution models, and the regulatory environment continue to put additional strain on boards and their staff. This is particularly felt at larger complexes, where these industry dynamics are most likely to have an impact. Another influence is restructuring and M &A activity, which has eliminated some boards while increasing the responsibilities of the surviving boards (and making them more likely to take an accompanying pay increase).

Chair fees have also impacted board compensation in recent years. The vast majority of independent chairmen (as well as lead independent directors) now receive an extra fee. Additionally, the increasing focus in particular areas such as compliance, valuation, and complex investments and derivatives has continued to add to workloads for committees. Furthermore, new committees are being formed and the chairs of those committees are more likely to be paid an additional chair fee. This can have an effect on the median compensation for boards.

Pay structures have been in flux over the past few years. Recently there was a trend, particularly by larger boards, toward decreasing the impact of meeting fees, and in some cases paying a flat retainer, due to the encompassing nature of the job. Some felt that a retainer covering all of a director's duties and activities was more appropriate. The events of 2008-2009 prompted many boards to reconsider this option. The result has been renewed interest in a more flexible structure that may still include a fixed retainer, but that also has a mechanism to allow additional pay for extraordinary circumstances or events, up to an annual maximum.

Below is a sample of the pay range for a particular grouping of fund boards:

Range of Trustee Compensation for Boards Overseeing $7 billion to $15 billion in AUM (in Percentile)

	10th	25th	50th (median)	75th	90th
$7 B to $15 B	$53,170	$66,125	$84,475	$114,563	$153,925

The wide range of pay from the 10th to the 90th percentile in this illustrative grouping demonstrates that it can be difficult to properly assess pay using just one or even two metrics. For this reason MPI has continued to assess board compensation based on factors beyond AUM and the number of funds overseen.

This year MPI again assigned a “Degree of Difficulty” for boards across the industry based on metrics such as the presence of certain types of investments (i.e. foreign stock or high yield bonds), oversight of sub-advisors, and fund introduction activity. This methodology, in development over the past few years, once again provided a relatively steady progression of compensation as the level of complexity increased.

Median Director Compensation by Degree of Difficulty of Governance

Up to 120	Up to 130	Up to 140	Up to 150	Up to 160	Up to 170	Up to 180	Over 190	To 200
$15,000	$20,000	$40,000	$54,255	$77,520	$150,000	$183,128	$215,250	$186,938

Note: Not comparable year over year. Specific analysis for an individual fund family requires qualitative as well as quantitative factors.

The relative cost of fund governance remains a mere fraction of the total costs of running a fund. Total director compensation per $1 million in AUM amounted to just $17.94, nearly unnoticeable in comparison to the $10,000 in all other expenses a typical mutual fund might incur. The “Total Cost of Governance”, which is the total amount paid to US fund directors as well as other board expenses such as T&E and legal expenses (as reported by NSAR filings), was $320 million, up 18% from last year but still representing only a fraction of a basis point against the total industry assets. Independent directors provide a highly efficient system of oversight that is paid not by the US taxpayer, but rather by those who directly benefit from its protection.

MPI’s survey also found that 86% of all fund board members are independent and that 95% of fund boards already comply with the SEC’s proposed “super-majority” rule from a few years ago. Our survey found that the chairman of the board was independent 70% of the time, up from 60% three years ago.

The survey notes that the mutual fund industry is highly concentrated, with the top 25 complexes controlling about 72% of all fund assets. These 25 complexes have about 260 directors (including cluster boards). On average, each of these large complex directors oversees approximately $33 billion worth of assets, a much wider span of influence than even directors of NYSE companies.

Our data finds that 17% of all standing fund directors are female, a slight upward tick, while 20% of the newly appointed directors in 2010 were female. Retirement policies continue to draw attention, with “director emeritus” programs gaining interest. Retirement ages have been trending upward, but the most frequently reported retirement age remains at 72.

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Management Practice Inc. is a specialized consulting firm based in Stamford, Connecticut, and provides governance, economic, and business advice to mutual fund boards. More information regarding this report is available at www.MFGovern.com or from C. Meyrick Payne or Jay Keeshan at (203) 973-0535 or email JKeeshan@MFGovern.com.