

2018

ANNUAL REVIEW

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), the leading association representing regulated funds globally, 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.

In the United States,

1,710 INDEPENDENT DIRECTORS...*

oversee more than

11,000 REGISTERED FUNDS...**

with more than

\$21 TRILLION IN ASSETS...**

and represent the interests of more than

100 MILLION SHAREHOLDERS.

* As of January 1, 2019

** Data exclude unit investment trusts. Data for mutual funds and exchange-traded funds are as of November 30, 2018. Data for closed-end funds are as of September 30, 2018.

Contents

2 Letter from the Governing Council Chair

3 Letter from the Managing Director

4 Education—Building Director Expertise

6 Outreach—Facilitating Director Engagement

8 Advocacy—Sharing the Director Perspective

10 Governing Council Members

11 IDC Staff

12 2018 Activities

Letter from the Governing Council Chair



DAWN M. VROEGOP

One hallmark of being a fund director is the simplicity of our core role: overseeing the activities of fund management as fiduciaries to funds and their shareholders. But simple is one thing, and easy is quite another. No director can be effective without broad knowledge of complex material and the sharp skills to put that knowledge to work. Building the two takes ample time, drive, and commitment.

Serving the financial interests of more than 100 million shareholders ought to be this demanding, and for that reason we welcome the many important responsibilities that our core role entails. At every decision point, it's their interests that guide our thinking—and their interests we diligently protect.

For a number of years, though, industry and regulatory developments have combined to make fulfilling this role more challenging. The ever-evolving fund business has added new layers to our work, and an accumulation of duties that are duplicative or better suited to fund management have too often competed for our attention.

The good news is that in 2018 the SEC's Division of Investment Management took some important steps toward enhancing board effectiveness. Through the division's board outreach initiative, its staff met with numerous boards, board counsel, and independent auditors over the past year to identify the areas where our oversight is most valuable and to determine whether a recalibration of our responsibilities is appropriate.

And stemming from that outreach, the division issued a no-action letter on some of the board responsibilities that duplicate the work of chief compliance officers. IDC hopes that more guidance is in the pipeline, and is keeping closely engaged with the division as work on its board outreach initiative continues.

But enhancing our effectiveness isn't a goal for regulators alone. It's one we can all embrace. As boards collectively, we can recruit a mix of directors who bring a broader, more diverse range of views to the table. We can help new directors better familiarize themselves with the funds they'll be governing and assimilate more smoothly to the culture they'll be joining. And we can evaluate our performance with clearer eyes and fairer minds.

As individual directors, we can be even more vigilant to potential conflicts of interest or activity that could work against fund shareholders. We can redouble our commitment to continuing education and development. And we can make a greater effort to learn from and connect with our peers.

To know IDC in 2018 was to know it as it always has been—an organization devoted to supporting the work of fund directors, ever on the lookout for ways to improve its services. At the heart of its endeavors isn't just a dedicated Governing Council and staff, but also a vibrant community of directors whose thoughtful insights and contributions enhance everything IDC does.

For as long as I've served on fund boards, it's been a privilege to be part of that community. Now, as chair of IDC's Governing Council, I'm grateful to be playing a leading role in it. I look forward to a productive year ahead, working with all of you in the service of fund shareholders.

A handwritten signature in black ink, reading "Dawn Vroegop". The signature is written in a cursive, flowing style. It is enclosed in a thin blue rectangular border.

Letter from the Managing Director

IDC is well known for its education and outreach programs—and it's not hard to see why. Year after year, they provide fund directors with opportunities to hone their craft and connect with one another, equipping them with the tools they need to thrive in their oversight role for the benefit of fund shareholders.

Our advocacy work might be less visible, but it's no less important. That held especially true in 2018, when a highly productive SEC issued numerous requests for comment, regulatory proposals, and rule amendments affecting the registered fund industry. Where the debates on these initiatives called for the perspective of fund directors, IDC responded with informed commentary and constructive recommendations.

One takeaway from our recent work with the SEC and staff is a marked shift in how they think about fund boards. For years, new tasks piled up with what sometimes felt like little thought about whether they would help directors serve shareholders. Now, the Commission and staff appear to be thinking more deeply about this—and establishing that a task would indeed be a valuable use of directors' oversight before imposing it on them.

This shift is showing in the SEC's regulatory work. In 2016, for example, the SEC revised its proposed liquidity risk management rule, seeking to ensure that no responsibilities assigned to boards fell outside their conventional oversight role. And in 2018, the Commission chose not to require boards to take on new responsibilities as a condition for fund sponsors to rely on its proposed ETF rule—rightly noting that an ETF's compliance program and board oversight of the program is enough to ensure compliance with the ETF's policies and procedures governing custom baskets.

We saw even more evidence at our 2018 Fund Directors Conference—where Dalia Blass, the director of the SEC's Division of Investment Management,



AMY B. R. LANCELOTTA

outlined a framework for the division to follow when it considers recommending board involvement as part of a new rulemaking and when it reevaluates existing board responsibilities.

This framework is a major development. Derived from what the division has learned through its board outreach initiative, the framework consists of factors to consider, including the policy goal of involving boards in a regulatory action, the level of involvement a board should have, and consistency with boards' oversight role. The division's recent no-action letter on board oversight of certain affiliated transactions reflects the principles of the framework.

Credit the SEC and staff for their commitment to modernizing the responsibilities imposed on fund boards. IDC has long engaged in dialogue with them about how best to tackle this enormous undertaking, and I'm pleased that we're beginning to see the fruits of our labor.

The fund director community can feel good about the progress we've seen here—and the regulatory outlook for the near term. Still, as those who've served on fund boards long enough know, outlooks are by no means guarantees—so IDC will be working hard to build on this progress in 2019. Thanks to your enduring support, I have every confidence we'll be able to do just that.

A handwritten signature in black ink that reads "Amy Lancellotta". The signature is written in a cursive, flowing style.

Education—Building Director Expertise

For fund directors of all levels of experience, education is crucial. To fulfill their oversight responsibilities and fiduciary duties, directors need a wide range of knowledge—not only about governance practices, but also about the latest regulatory, judicial, and industry developments. Throughout the year, IDC provides directors with learning opportunities of the highest quality to help them acquire this knowledge and continually build on it.

A Strong Foundation—and So Much More

Following a highly successful debut in Boston in September 2017, IDC's *Foundations for Fund Directors*® orientation program held three more in-person sessions in 2018—in Los Angeles, Chicago, and New York. At each of the sessions, directors participated in two days of instruction, case studies, and group discussion—deepening their understanding of fund structure and regulation, the guiding principles of fund governance, and the nuances of their complex responsibilities (see opposite page).

IDC's signature annual events—the Fund Directors Conference in Chicago and the Fund Directors Workshop in Washington, DC—hosted hundreds from the fund director community, who gathered to hear from some of the industry's top minds on an array of important issues facing fund boards (see opposite page).

Headlining the 2018 Fund Directors Conference, SEC Division of Investment Management Director Dalia Blass reflected on some of the lessons that she and her staff have learned from directors through her board outreach initiative—and updated attendees on some of her division's top priorities. Informative panel sessions focused on industry trends, enterprise risk, fair valuation, emerging technologies, and the US political landscape ahead of the midterm elections.

At the 2018 Fund Directors Workshop, held alongside ICI's General Membership Meeting, directors began the day at a roundtable discussion over breakfast—where they shared ideas about board composition, regulatory initiatives, and business issues shaping today's fund industry. Workshopers also heard from panels on getting ready for new requirements under the SEC's liquidity risk management and data modernization rules, how to make the most of the board's relationship with the chief compliance officer, and oversight of cybersecurity risk.

Leading the Way on the Web

Leading IDC's wide range of web-based education is a diverse webinar program that keeps directors informed on the latest governance and regulatory issues. In 2018, IDC hosted six webinars:

- » A discussion on the financial services, tax, and retirement policy agendas in Congress
- » A walkthrough of what a director might expect if faced with the prospect of being deposed as a witness in a civil litigation or interviewed by the SEC in an investigation
- » 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 overview of cybersecurity risk management programs, practices for board oversight of cybersecurity risk, and the types of cyberthreats facing fund companies
- » An in-depth look at board meeting mechanics, including the attorney-client privilege, practices for reviewing board books and board meeting minutes, and communicating with fund management outside meetings
- » A primer on the role of internal audit departments and how they interact with fund boards

Webinar archives are available at www.idc.org/idc_webinars.

At Foundations, Directors Get Ahead of the Curve—and Stay There

IDC's unique and innovative orientation program—*Foundations for Fund Directors*—is the essential director education resource. Lauded by newer and experienced directors alike, *Foundations* draws on the expertise of some of the foremost authorities in fund governance—to provide directors with the necessary knowledge and skills to succeed in their oversight role.

Learn Online and In Person

Foundations' blended education program begins with an online course that introduces directors to their core responsibilities. Participants then build on what they've learned with two days of interactive, hands-on practice through case studies and group discussion, led by fund directors with decades of experience.

Keep an eye on www.idc.org/foundations—or contact IDC's Conferences team at conferences@ici.org—for more details and registration information.

Knowledge and Skills You Need

Everything directors learn at *Foundations* is integral to their work to protect the interests of fund shareholders: ensuring and maintaining independence, overseeing potential conflicts of interest, reviewing a fund's advisory contract, evaluating fund performance, overseeing the fair valuation of portfolio investments, fulfilling responsibilities under the fund compliance program rule, and more.

Join Us in 2019!

January 30–31
Los Angeles

April 10–11
Chicago

September 25–26
Boston



The Fund Directors Conference—Where Our Community Meets

Each fall in Chicago, the fund director community convenes at IDC's Fund Directors Conference—the premier gathering for directors who want to grow their skills and keep up with the latest in the industry.

It's *the* place for directors to

- » hear insights from top regulatory officials and industry experts on some of the most critical issues facing fund boards;

- » learn the latest about the broad business and policy matters affecting the fund industry;
- » sharpen their governance skills;
- » strengthen their grasp of their core responsibilities; and
- » network with their peers.

Join us for our 2019 conference on **October 21–23**.



DALIA BLASS
Director, SEC Division of Investment Management



DAWN M. VROEGOP
Chair, IDC Governing Council

Outreach—Facilitating Director Engagement

Effective fund directors get information from many sources, but few sources are more important than their colleagues on other fund boards. That's why IDC works year-round to bring directors together for meaningful dialogue—at events where they can exchange ideas on governance practices, discuss what they've learned from past experiences, and share perspective on industry and regulatory developments.

Chapter Meetings

IDC's chapter meetings promote substantive conversation on the issues affecting fund directors, as well as those affecting the fund industry more broadly. Held in 10 locations across the country (see map below), these informal gatherings offer

directors a valuable opportunity to speak openly about their boards' governance practices and to learn from one another. The meetings attract both newer and experienced directors, while providing IDC with valuable insight on how to structure its programs in a way that best supports directors' evolving needs.

To supplement the discussion among directors, the chapter meetings also feature presentations from industry experts on key topics. Meeting presentations in 2018 covered how the markets are affecting portfolio management, what to include in board reports on a variety of subjects, the SEC's examination program, modernizing director responsibilities, cybersecurity initiatives in the fund industry, valuation, liquidity, and more.

IDC's Chapter Meetings in 2018*



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

Industry Segment Conference Calls

IDC's industry segment conference calls offer directors a discussion forum tailored to their specific board roles, where they can focus on the unique issues they face in those roles. IDC held 12 of these calls in 2018—three each for directors of small fund complexes, governance committee chairs, audit committee chairs, and board leaders.

DIRECTORS OF SMALL FUND COMPLEXES. Whether on governance practices, regulatory challenges, or other issues, directors of small fund complexes often bring a perspective that differs from that of their counterparts at larger firms. This call offers these directors an opportunity to converse with colleagues also at smaller firms, who understand the issues they face and can share valuable insight on how best to approach them.

GOVERNANCE COMMITTEE CHAIRS. Governance committee chairs identify qualified board candidates, recruit effective directors, and put together committee charters. This call gives these directors a place to talk shop about the best tools and processes for handling these items—and bring back new ideas to their fellow board members.

AUDIT COMMITTEE CHAIRS. Audit committee chairs handle challenges like guidance from the SEC and the Public Company Accounting Oversight Board,

audit quality, auditor independence, fund accounting and reporting, and valuation. On this call, directors offer wide-ranging perspectives to addressing these challenges and others.

BOARD LEADERS. Interacting with management, building an effective board, crafting board meeting agendas, and making the most of executive sessions are just a few of the tasks handled by independent board chairs and lead independent directors. On this call, board leaders can bounce ideas off each other for handling those tasks, contributing useful, enlightening tips.

Board Meetings

IDC and ICI host meetings for boards of ICI member funds at ICI's state-of-the-art facilities in Washington, DC, where both IDC and ICI staff are available to discuss governance issues and update boards on industry and regulatory news. The facilities include a 70-seat boardroom, and the Washington location 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 2018, IDC and ICI hosted four board meetings, while IDC and ICI staff participated in 12 others.

EFFECTIVE FUND DIRECTORS GET INFORMATION FROM MANY SOURCES, BUT FEW SOURCES ARE MORE IMPORTANT THAN THEIR COLLEAGUES ON OTHER FUND BOARDS.

Advocacy—Sharing the Director Perspective

It's critical that fund directors have a voice in the policy debates that could affect the way they serve the interests of fund shareholders. In 2018, as the SEC proposed, considered, and finalized a number of rulemakings with provisions for fund governance and implications for fund shareholders, IDC worked to ensure that these rulemakings took the unique and important perspective of directors into account.

Liquidity Risk Management

In comments on the SEC's proposed amendments to reform how funds will report information to the public under its liquidity risk management framework, IDC endorsed the Commission's intent to adopt a narrative approach to disclosure in place of requiring funds to report their liquidity classifications every quarter.

This narrative approach will obligate funds to describe in shareholder reports how—and how well—their liquidity risk management programs worked over the past year, and will provide shareholders with clearer, more useful information than could have been possible under the quarterly reporting requirement.

Auditor Independence Rules

Applauding the SEC's proposed amendments to its auditor independence rules, IDC joined with ICI in recommending that the Commission tighten the rules by narrowing the scope of the term *audit client* and defining lending relationships to capture only the relationships that raise actual independence concerns.

IDC and ICI's letter explains that fund board audit committees have spent a lot of time and resources working with their auditors on this issue, and that funds and their shareholders would be better served if the audit committees could focus their time and energy on legitimate threats to independence, as well as fund accounting, financial reporting, and internal control processes.

ETF Rule

The SEC proposed to allow most exchange-traded funds (ETFs) to begin operating without the cost and delay of obtaining individual exemptive orders. IDC's supportive response explained how the rule would make the ETF regulatory framework more consistent and efficient, level the playing field for ETFs that have been operating under inconsistent exemptive orders, and increase ETF competition and innovation.

Citing the fund compliance program rule's robust oversight framework and boards' oversight of ETFs, IDC strongly agreed with the rule's approach to not impose any new responsibilities on fund boards as part of the conditions to rely on the rule.

Fund Disclosure

IDC filed a letter with the SEC supporting efforts to modernize fund disclosure requirements in ways that help investors focus on and understand key information about funds and that reduce fund costs. The letter responded to the Commission's request for comment on ways to enhance fund disclosure that would improve the experience of retail investors and help them make more informed investment decisions.

Among other recommendations, IDC urged the SEC to allow registered funds to deliver prospectuses online as the default option—with the same approach that the Commission adopted for shareholder reports earlier in 2018—and expressed support for the agency to permit funds to deliver summary shareholder reports. IDC also objected to requiring funds to disclose a standardized risk measure or risk rating—because risk is multifaceted and thus cannot be captured in a single metric.

Fees for Distributing Fund Materials

Responding to the SEC's request for comment on the fee framework for distributing fund materials—including shareholder reports and prospectuses—IDC asserted that the framework creates a conflict of interest that leads to artificially higher costs for fund shareholders.

As IDC explained in its letter, a fund's intermediary chooses a vendor to deliver fund materials to the fund's shareholders—and negotiates the price for doing so—but the vendor bills the fund for the cost of delivery. This gives the intermediary no incentive to negotiate a competitive fee for the benefit of the fund's shareholders, and the fund has no choice but to pay the vendor's bill. IDC advocated that the SEC eliminate this conflict of interest and foster competition in the market, by allowing funds to choose their own delivery vendor and to negotiate the fees they pay.

Proxy Voting

With interest in proxy voting heating up in 2018, the SEC hosted a roundtable on the subject to hear the views of investors, issuers, and other market participants on a number of matters related to the proxy process and the rules governing it.

Ahead of the roundtable, IDC submitted a letter to provide background on the role that fund boards play in proxy voting. The letter explains that a fund's

board, acting on behalf of the fund, is responsible for voting proxies, but typically delegates this responsibility to the fund's adviser—in recognition that proxy voting is part of the investment management process. The board maintains ongoing oversight of this function as part of its fiduciary duties to the fund. IDC stated further that boards play an important role in the process for voting the proxies of the companies in their funds' portfolios, and thus will monitor any regulatory developments in this area and engage where appropriate.

Board Responsibilities

In response to a request from IDC, the SEC's Division of Investment Management issued a no-action letter on board determinations under the Commission's rules governing affiliated transactions. The letter essentially permits a fund board to receive a written representation from the fund's chief compliance officer (CCO) confirming that transactions effected in reliance on the affiliated transactions rules complied with procedures adopted by the board, rather than having to determine compliance itself. In doing so, the letter eliminated board responsibilities that duplicated functions commonly performed by or under the supervision of CCOs.

Governing Council Members (AS OF JANUARY 1, 2019)

Dawn M. Vroegop, Chair*

Brighthouse Funds and Driehaus Funds

Jonathan F. Zeschin, Chair Emeritus*

Matthews Asia Funds

Julie Allecta

Salient Funds and Litman Gregory Masters Funds

Kathleen T. Barr

William Blair Funds and Professionally Managed Portfolios

Donald C. Burke

Duff & Phelps Funds and Virtus Funds

Gale K. Caruso

Matthews Asia Funds and Pacific Life Funds

David H. Chow

MainStay Funds and VanEck Vectors ETF Trust

Susan C. Coté

SEI Funds

Bruce Duncan*

T. Rowe Price Funds

William R. Ebsworth

Wells Fargo Funds

Susan C. Gause

Brighthouse Funds and HSBC Funds

Anne M. Goggin

Pax World Funds

George J. Gorman

Eaton Vance Funds

Keith F. Hartstein

PGIM Funds

Cecilia H. Herbert

iShares Funds

Cynthia Hostetler*

Invesco Funds

Marie L. Knowles*

Fidelity Fixed Income and Asset Allocation Funds

Thomas P. Lemke

JP Morgan Exchange-Traded Fund Trust, SEI Funds, and Symmetry Panoramic Trust

Joseph Mauriello

Fidelity Equity and High Income Funds

Joanne Pace

OppenheimerFunds

Steven J. Paggioli*

AMG Funds and Professionally Managed Portfolios

Cynthia R. Plouché

Northern Funds and Baring Funds

Sheryl K. Pressler

Voya Funds

Erik R. Sirri*

Natixis Funds, Loomis Sayles Funds, and Natixis ETFs

Laura T. Starks*

TIAA-CREF Funds

Terence J. Toth

Nuveen Funds

Ronald E. Toupin Jr.*

Guggenheim Funds and Western Asset Inflation-Linked Funds

**On the ICI Board of Governors*

Note: All members of the Governing Council are independent directors at the fund groups listed under their names.

IDC Staff



Managing Director

AMY B. R. LANCELLOTTA

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

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 is a graduate of the University of North Carolina and the University of Virginia School of Law.



Senior Associate Counsel

LISA CHAIKIN HAMMAN

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 is a graduate of the University of Michigan and Suffolk University Law School.

2018 Activities

Foundations for Fund Directors Orientation Program: In-Person Sessions

- » Los Angeles (January)
- » Chicago (April)
- » New York (September)

Comment Letters

- » Investment Company Liquidity Disclosure (May, SEC)
- » Auditor Independence with Respect to Certain Loans or Debtor-Creditor Relationships (July, SEC)*
- » Draft 2018–2022 Strategic Plan for Securities and Exchange Commission (July, SEC)
- » Exchange-Traded Funds (September, SEC)
- » Request for Comment on Fund Retail Investor Experience and Disclosure (October, SEC)
- » Request for Comments on the Processing Fees Charged by Intermediaries for Distributing Materials Other Than Proxy Materials to Fund Investors (October, SEC)
- » Roundtable on the Proxy Process (November, SEC)

Webinars

- » Legislative Update—An Overview for Fund Directors (February)
- » What Happens When a Fund Director Is Involved in Litigation? (May)
- » Fund Industry Litigation, SEC Enforcement Activity, and Director Indemnification and Insurance (June)
- » Cybersecurity—Considerations for Fund Directors (September)
- » Board Meeting Mechanics—Practical Issues for Directors (October)
- » Internal Audit: Its Role and Work with a Fund's Board (December)

* Filed jointly with ICI

No-Action Letters

- » Request for No-Action Position Regarding Board Determinations Under Rules 10f-3, 17a-7, and 17e-1 (October, SEC)

Industry Segment Conference Calls

- » Directors of Small Fund Complexes (February, June, September)
- » Board Leaders (February, June, September)
- » Governance Committee Chairs (February, June, September)
- » Audit Committee Chairs (February, June, October)

Conferences

- » Fund Directors Workshop (May)
- » Fund Directors Conference (October)

Chapter Meetings

- » New York (March, September)
- » Jupiter, FL (March)
- » Washington, DC (March, October)
- » Philadelphia (April, September)
- » Chicago (April)
- » Denver (April)
- » Boston (April, September)
- » Texas and Arizona, by conference call (April)
- » Los Angeles (June, December)
- » San Francisco (June, December)
- » Charlotte (June)



INDEPENDENT DIRECTORS COUNCIL

Committed to Strong Fund Governance

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