

Fund Directions

The monthly issue from Fund Director Intelligence www.funddirectorintelligence.com

In This Issue

Fidelity Gets Active

Fidelity Investments has filed registration statements for its first two actively managed exchange-traded funds and given oversight of ETFs to its board overseeing fixed-income and asset-allocation funds.

See story, page 2

Ready For Rise In Rates?

Closed-end funds are beginning to prepare for the inevitable: a rise in interest rates. Some boards already have approved changes in their funds' investment strategies, and closed-end fund market professionals recommend all boards start a dialogue on this issue.

See story, page 5

ICI, IDC Talk Funds

Fund industry executives and trustees discussed valuation, social media, reaching young investors, and investing in the Chinese market at the *2013 General Membership Meeting* in Washington, D.C., in early May.

See coverage, pages 13-14

Governance	3
Regulatory	6
People & Funds	12
Learning Curve	15

Stormin' Norman

Champ Meets Resistance In Board Outreach

Norm Champ, director of the **Securities and Exchange Commission's** Division of Investment Management, has started meeting with independent mutual fund directors, but not everyone has been responsive. On advice from counsel, several individuals and full boards have declined Champ's invitation to meet, according to industry sources, who told *FD* directors are skittish

(continued on page 9)

Series Trust Sponsors Find Silver Lining In Northern Lights Case

After publicly putting series trusts under scrutiny last year, the **Securities and Exchange Commission** on May 2 settled charges against the board and chief compliance officer of **Northern Lights Fund Trust** and **Northern Lights Variable Trust** for 15(c) infractions that were not specific to a series

(continued on page 7)

IN THE BOARDROOM

Nationwide Adds Educational Sessions To Quarterly Meetings

The **Nationwide Funds** board recently launched plenary educational sessions at each of its quarterly board meetings to give the independent directors an opportunity to discuss issues in an unstructured way. "They utilize the afternoon



Michael Spangler

(continued on page 6)

Unauthorized reproduction, uploading or electronic distribution of this issue, or any part of its content is illegal without the Publisher's written permission. Contact us at (800) 437-9997.

INVESTED IN THE WORLD



At Press Time

Fidelity Tosses A Curve On ETF Oversight

Fidelity Investments has assigned oversight of its first two actively managed exchange-traded funds to the board overseeing its fixed-income and asset-allocation fund families. The investment mandates of the *Fidelity Mortgage Securities ETF* and *Fidelity Corporate Bond Exchange Traded Fund* fit in with those of the funds already under the board's auspices, but market participants had predicted earlier this year that Fidelity's ETFs would be assigned to the soon-to-launched Select funds board.

The new Select funds board is expected to be in place around Aug. 1 and will oversee Fidelity's 64 actively managed sector-based funds (*FD*, March). Market participants anticipated ETFs from Fidelity modeled after the Select funds, therefore making it logical for the new board to oversee the ETFs. However, the first two funds' investment mandates are more in line with the Boston firm's fixed-income funds.

"Because the two ETFs are fixed income, we thought it would be appropriate they be overseen by the fixed-income and asset-allocation board," a Fidelity spokesman told *FD*. He said the firm would evaluate each new ETF it launches to determine which board will have oversight.

The fixed-income and asset-allocation board is chaired by **Abigail Johnson**, president of Fidelity, and also includes interested trustee **James Curvey**. The independent trustees are **Albert Gamper**, **Robert Gartland**, **Arthur Johnson**, **Michael Kenneally**, **James Keyes**, **Marie Knowles**, **Kenneth Wolfe** and **Elizabeth Acton**. Acton, a retired executive v.p. and president of finance at **Comerica Inc.**, is new to the board, having joined this year. She has experience as a corporate board director. Fidelity also has a board that oversees equity and high-income funds.

Fidelity filed registration statements for the two ETFs just weeks after being granted exemptive relief from the **Securities and Exchange Commission** to do so on May 10. The firm first sought permission to offer actively managed ETFs in December 2012.

Tell Us What You Think!

Questions? Comments? Criticisms?
Do you have something to say about a
story that appeared in *FD*? Or is there
information you'd like to see published?

Managing Editor **Hillary Jackson** can be reached
at 212.224.3964 or hjackson@iintelligence.com.

Fund Director Intelligence

EDITORIAL

Steve Murray
Editor

Tom Lamont
General Editor

Hillary Jackson
Managing Editor
(212) 224.3964

Stanley Wilson
Washington Bureau Chief
(202) 393-0728

Kieron Black
Sketch Artist

PRODUCTION

Dany Peña
Director

Deborah Zaken
Manager

Melissa Figueroa,
James Bambara
Associates

Jenny Lo
Web Production &
Design Director

ADVERTISING

Patricia Bertucci
Associate Publisher
(212) 224-3890

PUBLISHING

Anna Lee
Marketing Director
(212) 224-3175

Archana Kapur
Senior Marketing Manager
(212) 224-3421

Vincent Yesenosky
Head Of U.S. Fulfillment
(212) 224-3057

Nina Bonny
Customer Service Manager
(212) 224-3433

Robert Dunn
Commercial Director
(212) 224-3712

SUBSCRIPTIONS/ ELECTRONIC LICENSES

John Diaz
Account Manager
(212) 224-3366

Julien Waite
Account Manager
(212) 224-3253

REPRINTS

Dewey Palmieri
Reprint & Permission
Manager [New York]
(212) 224-3675
dpalmieri@institutionalinvestor.com

CORPORATE

Richard Ensor
Chairman

Jane Wilkinson
Chief Executive Officer

Customer Service

PO Box 4009, Chesterfield, MO 63006-4009, USA
Tel: **1-800-715-9195**
Overseas dial: **1-212-224-3451**
Fax: **212-224-3886**
UK: **44 20 7779 8704** Hong Kong: **852 2842 8011**
E-Mail: customerservice@iintelligence.com

Institutional Investor Hotline

(212) 224-3570 and (1-800) 437-9997 or Hotline@iintelligence.com

Editorial Offices

225 Park Avenue South, New York, NY 10003

Fund Directions is a general circulation newsweekly. No statement in this issue is to be construed as a recommendation to buy or sell securities or to provide investment advice.

Fund Directions ©2013

Institutional Investor, LLC Issn# 1076-4135

Copying prohibited without the permission of the publisher.

COPYRIGHT NOTICE: All materials contained in this publication are protected by United States copyright law and may not be reproduced, distributed, transmitted, displayed, published, broadcast, photocopied or duplicated in any way without the prior written consent of Institutional Investor. Copying or distributing this publication is in violation of the Federal Copyright Act (17 USC 101 et seq). Infringing Institutional Investor's copyright in this publication may result in criminal penalties as well as civil liability for substantial money damages. ISSN# 1076-4135

Postmaster

Please send all undeliverable Mail and changes of addresses to:
PO Box 4009 Chesterfield, MO 63006-4009 USA

 Institutional Investor
Intelligence

Governance

New Valuation Guidelines Offer CCOs Help

The **International Organization of Securities Commissions** has issued a report that lays out principles for valuing portfolio assets and which could serve as a useful tool for boards and chief compliance officers concerned about regulators' increasing scrutiny of valuation policies.

"The IOSCO release lays out some useful principles that CCOs can apply and does so at a pretty high level," **Glen Barrentine**, special counsel with **Cadwalader Wickersham & Taft**, told sister service *Compliance Intelligence*. The IOSCO guidelines name 11 specific principles firms should follow in developing and implementing procedures to value their assets (see box).

The report revises IOSCO's original principles, which were developed in 1999. The new guidelines are designed to account for many complex and hard-to-value assets that didn't exist at the time of the earlier release. A number of these assets may require the judgment of fund management because their value cannot be determined using quoted prices—thereby creating the need for a set of guidelines to properly mark them, officials wrote in a related filing.

Barrentine cautioned, however, that CCOs likely will need to do more with regard to valuation procedures than simply develop policies that adhere to the

principles laid out by IOSCO. The **Securities and Exchange Commission** is very focused on valuation and "is expecting CCOs to be a lot more involved in the process than they've previously been," he noted.

For instance, the Commission has "set a very high bar for those that the SEC views as gatekeepers, a category which can include a fund's board or its CCO," Barrentine said. The agency will look to gatekeepers if something goes wrong and see if there was a weakness in a firm's procedures that they ought to have prevented, he said.

Compliance officers also should pay special attention to how harder-to-value assets are marked, Barrentine added. "I would urge CCOs to take a risk-based perspective," he said, pointing to a recent settlement between the SEC and two **Oppenheimer Holdings** subsidiaries. In the administrative proceeding at issue, the SEC accused the Oppenheimer subsidiaries of making misrepresentations and omissions to investors and prospective investors about the asset value of a fund of private equity funds they managed. According to the agency, although the advisors' written policies and procedures required the compliance department to review and approve marketing materials, the procedures did not require a review of portfolio manager valuations and were not reasonably designed to ensure valuations were determined in a manner consistent with written representations to investors.

The firms settled without admitting or denying

Compliance Checklist: Valuation

IOSCO laid out the following principles for the valuation of collective investment scheme assets:

- Fund firms should establish comprehensive, documented policies and procedures governing valuation.
- Policies should identify methodologies to value each type of asset a fund holds.
- Policies should address conflicts of interest.
- Valuations should be conducted in a consistent manner and in accord with policies.
- Firms should establish policies to detect, prevent and correct pricing errors and, if such errors harm investors, the errors should be addressed immediately and the investors fully compensated.
- Firms should periodically review valuation policies for appropriateness and effectiveness and a third party should review the policies annually.
- Firms should conduct due diligence on third parties that perform valuation services.
- Firms should ensure valuation procedures are disclosed to investors in offering documents or otherwise made transparent.
- The purchase and redemption of fund shares should not be effected at historic net asset value.
- Fund portfolios should be valued on any day that fund units are purchased or redeemed.
- Fund NAVs should be available to investors at no fee.

wrongdoing. A spokesman for Oppenheimer said at the time there had been full cooperation with authorities during the investigation and that **Oppenheimer Asset Management** had “put in place additional policies and procedures designed to ensure that valuations of portfolio positions in its marketing documents are determined in a manner consistent with its obligations to investors.”

Board Scrutiny Fuels Interest In Liabilities, Insurance Coverage

One of the most-discussed topics among independent directors of late is their own liability and what kind of insurance coverage they carry, the result of increased attention on their responsibilities.

In response, **ICI Mutual** has published a guide to independent director liability (IDL) insurance that is designed to provide a comprehensive analysis, according to **Daniel Steiner**, general counsel. “There is a dearth of good information out there on IDL insurance in the fund industry,” he said. **John Mulligan**, senior v.p. and chief underwriting officer at ICIM, added that he spends a lot of time explaining how IDL coverage works and the distinction between “safety net” and “side A-only” policies.



John Mulligan

Safety net IDL insurance, which is sometimes called “side A&B” or “broad form” insurance, covers both indemnifiable and non-indemnifiable exposures of independent fund directors in cases where the fund’s underlying D&O/E&O insurance does not respond. Side A-only insurance covers only non-indemnifiable exposures. The guide, published on the ICIM website, details the differences between the two types of coverage and provides a list of questions boards can ask when evaluating whether to add IDL coverage and what type to choose:

- What are our rights to fund indemnification and advancements?
- What is the nature and amount of our fund’s D&O/E&O insurance?
- What scope of coverage is provided to independent directors under our funds’ D&O/E&O insurance?
- Do we believe it necessary or appropriate to obtain IDL insurance?
- What options do we have with regard to IDL

insurance?

- How important are difference-in-conditions provisions?
- Which type of IDL insurance do we prefer?
- How much IDL insurance is enough?
- Who can advise us on IDL insurance issues?

Although ICIM states in the guide that safety net coverage “is, on balance, a better choice” because of the breadth of coverage and protection of fund assets, Steiner said the decision for an individual board comes down to business judgment. “Different boards come to different decisions” based on a number of factors, particularly the scope of the underlying insurance already in place, he said, recommending boards consult counsel and insurance advisors during the decision-making process.

Stupid Questions? Ask Them In A Pre-Meeting Meeting

There’s no such thing as a stupid question. Well, that may be true, but there is, perhaps, a time and a place for mutual fund directors to ask certain preliminary questions—and that may be before the board meeting, outside the boardroom (and off the record).

Boards should consider scheduling pre-meeting conference calls to give directors the opportunity to get preliminary questions, concerns and information requests out of the way ahead of a regularly scheduled meeting, according to **David Mahaffey**, managing partner and co-leader of the Investment Management Group at **Sullivan & Worcester** in Washington, D.C.

Jeffrey Young, interested chairman of **Valued Advisors Trust**, noted the topic was discussed at a half-day **Advancing Fund Governance**



David Mahaffey

meeting in Cincinnati in late April, and a participant recommended boards use pre-meeting calls “to ask the stupid questions and not be on the record.” That, he told *FD*, “is a great way of putting it...It gives board members a chance to ask questions about material and everything on the meeting agenda...and engage in discussion.”

Although scheduling a pre-meeting call can be difficult because of time constraints on the directors and the need to disseminate meeting materials earlier—ahead of the call rather than in time for the meeting itself—there are benefits that outweigh these administrative burdens, Mahaffey told *FD*. The biggest is the opportunity for

directors to identify missing or incomplete information necessary for the board to make a decision or take action. Also, directors can ask questions and have discussions in a more candid atmosphere. “They might be willing to ask a question they’re not willing to ask in a room with 20 people,” he said. “I think it’s really helpful. There are other ways to get to the same result, but I think it’s something boards should consider.”

Mahaffey noted that each board should determine for itself the best way to conduct pre-meeting sessions. Some do it before every meeting; others do it only before the most intense meetings, such as when

the annual 15(c) reviews are scheduled. Mostly, the sessions are off the record and include either the chief compliance office or independent counsel. Sometimes interested trustees are included, but not always. “We want it to be as informal and candid a session as it can be,” he said. To the argument that the board meeting is not necessarily more efficient if it’s split up into a two-hour call and a four-hour meeting (rather than a single six-hour meeting), Mahaffey pointed out that, generally, people find it easier to pay attention and function at a high level for shorter periods of time. “Everybody who’s ever tried it ends up keeping on using it,” he maintained.

Closed-End Funds Prep For Rise In Rates

Closed-end funds are beginning to position themselves for a rising interest rate environment by seeking approval from their boards—and in some cases, their shareholders—for a more flexible investment mandate. If these discussions haven’t already begun to take place in the boardrooms of bond and interest rate-sensitive equity closed-end funds, now is a good time to get started, according to **Cecilia Gondor**, executive v.p. and cio at **Thomas J. Herzfeld Advisors**.



Cecilia Gondor

“It’s a good time to prepare for the future. Rates have been so very low for an extended period of time, and I would expect they won’t stay low,” Gondor told *FD*. “Look at how the markets have changed, look at what kind of future changes there may be to the market if rates do rise, and evaluate if the portfolio manager has enough latitude to cope. Does the manager need additional latitude? [Does the manager] need a shift in focus?”

Although open-end funds also have to prepare for a changing interest rate environment, closed-end funds may have a more immediate need because of their use of leverage, Gondor noted. And, because closed-end funds, on average, have narrowed the discounts at which they’re trading or are even trading at a premium, the good will among shareholders should make the process easier, she added. “We’re seeing at this point in time that it is a very favorable window of opportunity... Funds are at premiums, there is not a lot of dissident activity; it’s a more favorable time to ask shareholders for a non-routine measure because you don’t have

other pressures,” she underscored. “If there’s a wide, persistent discount or bad performance, it’s harder to get approval.”

Boards should begin by asking portfolio managers how they have benefited from the current low-interest rate environment and how the fund will be affected when rates inevitably rise, Gondor said. “Let the portfolio manager describe what they have in mind and then ask if the [strategy] allows them to fulfill the objective of the fund; ask them for their wish list now.”

Some funds already have begun the process. In December, **Cohen & Steers** announced its *Cohen & Steers REIT & Preferred Income Fund* would use a combination of fixed- and variable-rate financing to manage interest rate risk; the **PIMCO Funds** board in April approved the altering of the *PIMCO High Income Fund*’s mandate to invest in interest-only and principal-only securities, as well as inverse floaters; and the board of the *Fort Dearborn Income Securities Fund* in late May approved an adjustment to the fund’s portfolio duration range, from +/- two years to +/- three years, in order to reduce its interest rate risk profile.

Tom Westle, a partner at **Blank Rome** in New York, said both closed- and open-end mutual funds will need to prepare for rising rates by relaxing some of their investment parameters—and possibly changing their names if strategies are altered too much. For closed-end funds, now is a good time to approach shareholders and make changes, he agreed, but he pointed out that the process isn’t necessarily easy even if the timing is good. “This does take management doing their homework, sitting down with the board and getting the board comfortable with the direction the fund is going to take,” he told *FD*. “A good board asks questions of management.”

Nationwide (Continued from page 1)

session to come together without an agenda,” **Michael Spangler**, president of **Nationwide Funds Group**, told *FD*. “It’s a more informal, open forum.”

To make time for the new plenary sessions, the board also began holding concurrent committee meetings. Each committee chairman debriefs the full board, and the whole process is more efficient and beneficial to the trustees who oversee the 95 Nationwide funds, Spangler said. “There’s value for me as well,” he added, noting he often sits in on the plenary sessions.

Regulatory

ICI’s CFTC Cost/Benefit Appeal In Trouble

The chief judge of the **D.C. Circuit Court of Appeals** has raised the possibility that the industry’s appeal against **Commodity Futures Trading Commission** regulation may be rejected because the circuit does not have a basis for estimating how much the rule would cost fund firms. The court is unsure how much easier a pending CFTC harmonization rule would make it for fund firms with commodity pools to comply with its rules. Judge **Merrick Garland** said after the contents of the harmonization rule are known, “if the costs turn out to be high, [the industry can] object to that, then.”

A suit brought by the **Investment Company Institute** and the **U.S. Chamber of Commerce** alleges that the CFTC, in imposing its regulations on mutual funds that participate in the commodity futures markets, failed to adequately analyze the costs it would impose on firms. The plaintiffs lost in district court. In oral arguments before the circuit judges they seemed to face a lot of skepticism, particularly from Garland. But it was the judge thought to be most friendly to the industry side, **David Sentelle**, who elicited from CFTC Deputy General Counsel **Jonathan Marcus** the information that once the harmonization rule is implemented the agency would recast its cost/benefit ratio to take into account the new information. If a new cost/benefit ratio will be calculated later, it seems unlikely the court would make a ruling now.

Industry lawyers following the litigation said that the circuit only can deliberate based on evidence already brought before it. “If the industry loses this appeal, it could get another bite at the apple [by suing a second

The topics of discussion for the educational sessions are selected by the trustees themselves—“their ideas and their suggestions,” Spangler reported. Recent topics have included valuation, brokerage commissions and fees, and 15(c) methodologies and processes. The sessions include presentations and input from representatives from Nationwide as well as external firms.

The fully independent board is chaired by **David Wetmore** and includes **Charles Allen**, **Paula Cholmondeley**, **Phyllis Dryden**, **Barbara Hennigar**, **Barbara Jacobs**, **Keith Karlawish**, **Douglas Kridler**, and **Carol Kosel**, who joined in March.

time, based on the new cost analysis CFTC is going to do after the harmonization rule can be cranked into the overall regulatory burden picture]. But it would be a more difficult case to make because there would be a smaller target to hit,” a senior Washington fund lawyer said.

SEC Cautions On Exemptive Relief Conditions

Mutual fund advisors that got exemptive relief from regulators to engage in activities not permitted by relevant statutes should set up policies and procedures—and involve the fund board—to ensure they are keeping the commitments they had to make to get the regulatory relief.

In a May *IM Guidance Update*, the **Securities and Exchange Commission’s** Division of Investment Management reminded companies they risk violating securities laws if they fail to comply with “representations and conditions” attached to exemptive orders; the consequences in such a case “may be severe.” One way to prevent violations is to have policies and procedures specifically designed to deliver on promises. By way of example, the DIM suggested that an order be conditioned on a board review. This would require either setting up a separate framework or amending existing policies and procedures.

The division guidance pointed out that in 2011 a report by the SEC’s Office of the Inspector General into whether firms were keeping the promises found some instances where that was not the case. That report also set off debate over whether the Investment Management and Trading and Markets divisions should be doing more to

follow up on whether representation and condition terms are being adhered to by parties getting relief.

The two divisions pointed to resource constraints on their manpower and said the policing of the behavior of advisors getting exemptive relief should continue to remain in the hands of examiners from the Office of Compliance Inspections and Examinations.

Whistleblower Alleges SEC Went Easy On Funds

A **Securities and Exchange Commission** lawyer is taking the agency to court with allegations that a senior official in the Commission's New York office refused to bring enforcement actions against investment advisors for nearly a decade. The complaint also alleges that the official's superiors declined to admonish him or correct this stance.

As first reported on the *Fund Industry Intelligence* website, **Kathleen Furey** on May 10 filed a complaint in the **U.S. District Court for the District of Columbia**, claiming the agency was "withholding records which demonstrate the misconduct of senior SEC officials in failing to enforce the [fund laws and] the misconduct of even higher level SEC officials in permitting subordinate supervisory staff to ignore" the laws they were sworn to enforce (*see the complaint here*). She asked the court to order the Commission to supply the internal documents that would back up her claims.

Furey said in her complaint that from 2000 to January 2009, the 20-member staff unit she was assigned to "did not seriously pursue" cases that might have led to administrative proceedings or civil actions under Investment Advisers Act of 1940 or Investment Company Act of 1940. She added when she brought this to her immediate superior in 2007, he said "we do not do IM (Investment Management) cases." Sources familiar with the Commission dispute Furey's claim, saying there was no moratorium by the New York Office on bringing actions against funds or advisors in the period of 2000 to January 2009.

Furey went two levels above her superior and, according to her court document, was told to either drop the issue or take it to the SEC's Office of the Inspector General. An IG report issued in 2008 said an investigation "found no evidence of misconduct" by the officials she accused.

Shortly after the IG report on Furey's allegations was

issued, the **Bernie Madoff** scandal was exposed by the 2008 financial crisis, and the SEC came under fierce attack for being unresponsive to whistleblower **Harry Markopoulos**. An appendix to the formal complaint submitted by her lawyers said: "The combined impact of Furey's disclosures and the Madoff scandal had a devastating impact on Furey's promising career. The formal [SEC] promotions would stop. The pay increases would slow and then stop...The performance evaluations would slip from exceptional, to acceptable, to needs improvement." The same document, an attachment to her court complaint, quotes her as emailing to the Office of the Inspector General: "In retrospect...I should have left immediately. It would all be over by now. But I believed HR [human resources] when they said I would be protected [for becoming a whistleblower]. And I might have been. Except for Madoff."

Instead, the complaint alleges it has been an ongoing, step-by-step struggle between Furey and the agency, which by law may not fire her so long as she is deemed a competent worker. The court now gets to decide which side has the merits of the issue—with Furey bearing the burden of proof—and whether or not to release the records.

An SEC spokesman declined to comment on the case.

Series Trust (Continued from page 1)

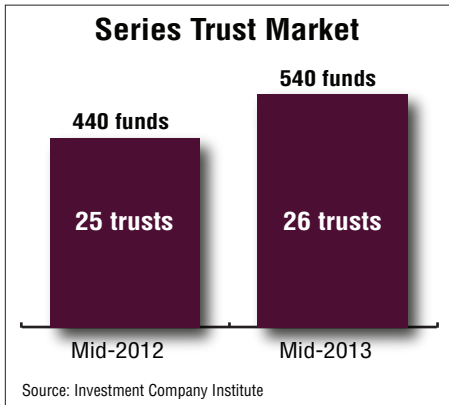
trust structure. This and the fact that the investigation yielded nothing more than fairly routine errors in processes are largely being viewed as a positive for the series trust marketplace—at least among those who sponsor series trusts.

The SEC did find fault with the five Northern Lights trustees and their CCO, charging them with "causing untrue or misleading disclosures about the factors they considered when approving or renewing investment advisory contracts on behalf of shareholders." The settlement requires the payment of \$50,000 in penalties by each of the two trusts and the hiring of a compliance consultant by the board. There was no admission or denial of guilt.

"It's a good thing for series trusts," one series trust insider told *FD*. "The SEC did a very thorough investigation of the structure and didn't come up with anything specific to it being a series trust. The SEC never says [it's] done with something, but it looked into it and that was what they came up with; the structure

withstood thorough scrutiny, and that's good for everybody."

Andrew Rogers, president of Northern Lights sponsor **Gemini Fund Services**, told *FD* he was "very pleased" with the outcome of the SEC's case against the two trusts. "They're not saying we were malicious in any way or that we harmed shareholders. This is



over technical processes that they thought were deficient. I understand what they're saying, and we agree with them." He pointed out that the infractions were brought to the attention of the

trusts and the board more than two years ago and have been addressed.

The SEC order found that some "boilerplate disclosures" related to the 15(c) process that were included in some fund series shareholder reports contained untrue or misleading information. The SEC also found a failure to follow policies and procedures regarding trustee approval of advisors' and sub-advisors' compliance programs.

Marshall Sprung, deputy chief of the Enforcement Division's Asset Management Unit, did focus on the series trust structure in a release from the agency: "These violations make clear that turnkey mutual fund arrangements can pose significant governance concerns, and trustees must be vigilant in ensuring that the funds they oversee meet their disclosure, compliance, reporting, and recordkeeping

obligations." **Jay Baris**, head of the Investment Management Practice at **Morrison & Foerster**, said it's obvious that the SEC is keeping series trusts in its crosshairs.

Rogers said the Northern Lights board has made its processes more "robust," enlisting outside counsel's assistance with preparing meeting minutes and ensuring they're reviewed in a more timely fashion. More in-depth compliance reports, summaries and presentations also are being done, he added, noting the trusts and boards are in the process of hiring the SEC-mandated compliance consultant.

Dave Carson, director of client strategies at **Ultimus Fund Solutions**, which sponsors one series trust, said there is no "inherent flaw" with the series trust structure but that all of its moving pieces must be monitored carefully. "It's more just watching all the possible risks, and certainly a piece of that is the number of advisors as well as the number of funds and strategies that are in the trust," he told *FD*. "I think the scrutiny is good because it encourages us all as sponsors to do our absolute best for the shareholders and the boards, and that's never a bad thing in my opinion."

Most agree that scrutiny isn't abating anytime soon. "The SEC is sending a message that they are looking in the boardroom [and] looking at the gatekeepers; they're sending a strong message," Baris told *FD*. "Directors should be careful not to rely on boilerplate disclosures." Rogers had specific advice for series trusts: "I can see why the SEC chose us to be examined," he said, pointing to the firm's fast growth and abundance of alternative investment funds. "The chances of an examination are higher than they were a couple years ago. I think you need to have more oversight, more policies and procedures reflecting the multiple types of funds and advisors," he added.

Got An Opinion?

Of course you do, and we want to hear it—and share it with *FD* readers!

Tell us what you think about the issues affecting fund directors and the broader fund industry.

Please submit your op-ed to:

Hillary Jackson, managing editor, hjackson@iintelligence.com

Champ Meets (Continued from page 1)

in the wake of two high-profile SEC cases targeting trustees and skeptical about Champ's objectives.

Champ has been saying for months that he wants to meet with boards in order to learn more about their responsibilities and, more specifically, solicit feedback from them on where they believe they add the most value and whether their job descriptions should be altered in some way. While he's not the first DIM director to reach out to directors, Champ is attempting to do so at a time when the relationship between the fund industry and the regulator is strained. And his pronouncement in March at an **Investment Company Institute** conference that directors serve as the "eyes and ears" of regulators has done him no favors (*FD*, April). "The tragedy is that he decided to reach out at the absolute worst time," one fund industry lawyer said.

"When Norm said at the conference that boards should be the eyes and ears of the division, that concerned folks," another fund lawyer told *FD*. "Clearly, the statements at the conference were very devastating; now there are lawyers advising their directors not to meet with [the SEC]."

Despite resistance on the part of some directors, Champ is making headway. He met April 30 with **Amy Lancellotta**, managing director of the **Independent Directors Council**, and several IDC members. Lancellotta declined to comment on the meeting, saying it was private, but Champ told *FD* the meeting included directors from some of the country's largest fund complexes. He declined to name any of the participants. **Susan Wyderko**, president and ceo of **Mutual Fund Directors Forum**, told *FD* her group also is working with Champ—primarily on DIM's efforts to update valuation guidance—though she declined to say whether MFDF had been invited to meet with the division director.

Another point of concern for directors is the possibility that Champ will bring along representatives from both the Office of Compliance Inspections and Examinations and Division of Enforcement, creating a less-than-relaxing atmosphere. A fund lawyer maintained that having OCIE and Enforcement in the room is too confrontational. "I'm fine with having the

meeting, but not if Enforcement is playing 'gotcha,' he said. "I heard one board found out Enforcement was coming along and said they needed more time to prepare and postponed the meeting."

Champ told *FD* his efforts are an attempt to "establish a dialogue" with both senior management and boards about policy issues. "Our discussions so far have generally included sharing what initiatives and projects the staff of the Division has prioritized...This is a voluntary dialogue, and firms are free to participate or not," Champ said. "There have been general statements in some news reports about firms receiving advice not to participate. In our experience, many firms have participated and found it helpful."

Indeed, **OppenheimerFunds'** senior management and boards have met with Champ, and sources familiar with the meetings told *FD* the experience was positive and constructive. "The intent of the staff was to learn things; it was not an issue of 'gotcha.' Everyone explained who they are, how they got to the table; it was a lot of questions and answers. It was not an antagonistic meeting," one individual reported of the May 21 meeting with the boards. Another individual familiar with the meeting described Champ as a "very reasonable, rational guy" and said there was no "threatening kind of tone in anything they said."

The independent chairmen of OppenheimerFunds' Denver and New York boards, **Sam Freedman** and **Brian Wruble**, respectively, declined to confirm or deny the meeting took place, as did independent counsel to the board **Paulita Pike** from **K&L Gates**. **Ari Gabinet**, general counsel to OppenheimerFunds, confirmed Champ met with senior management but would not confirm or deny the meeting with the boards. "We viewed [the meeting with senior management] as an extremely valuable and constructive dialogue," he said.

A fund lawyer added, however, that given the industry's general mistrust of and negative feelings toward the SEC, Champ will be unlikely to receive honest feedback. "It's not an easy call for boards as to whether they meet with the SEC. If they do, they need to be careful about what's explored and what's said," the lawyer told *FD*.



The Total Cost of Investment Ownership in Outsourcing: a Q&A with BNY Mellon Industry Leaders

Two leaders in the outsourcing industry—**Paul Gately**, Head of Global Outsourcing at BNY Mellon, and **John Lehner**, President and Chief Executive Officer of Eagle Investment Systems, and Head of BNY Mellon Global Outsourcing Services, Asset Servicing Division—provide their views on emerging trends in outsourcing middle- and back-office functions.



BNY MELLON

Q. Let's talk about the decision-making process behind the choice to outsource. What are the drivers behind the decision to move some functions from in-house?

GATELY: In our work, we see three distinct groups with different reasons for outsourcing. The first group is looking for speed to market. The second group desires, above all, to minimize execution risk. The third group is looking to more efficiently utilize their intellectual capital.

For example, managers who are expanding into new asset classes, such as traditional fixed-income managers who want to add alpha, are concerned with how quickly they can be up and operating around the new asset classes.

We have a number of clients who are acquisitive, and who are looking to minimize execution risk. They look to us to help them bring those disparate groups onto the same platform. These situations may involve challenges around asset classes or new geographies, and BNY Mellon delivers the know-how in managing large-scale integration projects.

Fund managers who are focused on achieving the best return on investment are typically evaluating which functions they can place outside the firm. Frequently, they start with the middle-office piece.

Q. What issues arise when fund management companies consider the costs of outsourcing? Are there some considerations that are sometimes overlooked?

GATELY: We find that a significant challenge for managers is measuring the true cost of ownership of the relevant process and its associated technology. Whether a firm is looking at just a snapshot in time, or a continuum, the key issue is whether or not those services are actually sustainable.

As an example, when fund managers examine their costs, they typically consider execution costs, such as trade settlement, and the technology costs for the current year and next. But there are many costs that aren't as tangible and so don't always get quantified. It is a rare investment manager who considers how the cost of data management solutions across the spectrum of research, middle office and sales and marketing. Many managers don't actually take into account that the cost is far greater than the two- or three-person headcount of the middle office.

There's also the requirement for reinvestment in new technology, and in keeping up with changing regulatory and technological standards. These costs can be hard to quantify, but may be substantial.

When you look at the total cost of ownership, the key point is that it is important to consider both the obvious and the not so obvious.

LEHNER: Cost, rather than an organization's ability to cope with change, often becomes a focal point, because the cost of outsourcing is one aspect that companies can grasp.

The true total cost of outsourcing – from people, process, bricks and mortar,

the IT and the data – then becomes the battleground, which is unfortunate because the time spent in justifying the cost would be better served in understanding the business or process change. Time is better spent considering what efficiencies and other benefits outsourcing will provide over time, and what options your company may gain that it currently doesn't have.

Q. How are companies blending the boundary between total in-house and complete outsourcing services? Is "co-sourcing" becoming more common?

GATELY: Because of our technological capabilities and the Eagle suite of products, clients can keep their standalone data solutions and add component outsourcing. A lot of the conversations we're having in the U.K. and U.S. are prospects telling us, "My operating system is fine, my trades aren't failing, I'm clearing with the market, but I have an issue with data management." Companies need to consolidate data from different operating systems, for example, to produce substantive client reports.

Clients are focused on their true pain points. Because of our offerings, we are able to have constructive conversations around varying levels of service.

LEHNER: Co-sourcing isn't one-size-fits-all. Some organizations may have already taken steps toward outsourcing, so by default co-sourcing is becoming more

common. Companies are often at different points along the continuum.

We are fortunate in that we are able to provide a thorough analytic process because of our broad spectrum of services. We're able to blend and create the right mix of services for clients. Because of the data management issues seen by many companies, co-sourcing is gaining momentum.

Q. From a client's perspective, what are the cost and speed advantages of relying on cloud computing for outsourcing functions, rather than installed technology?

LEHNER: The number one advantage is speed to new functionality, versus the on-premise model.

There are also two other distinct advantages. First is cost, because cloud computing avoids the need for the large fixed costs associated with data centers and employees. Second, because of the nature of how applications and data move in the cloud, access to data is much more open and available than in a traditional in-house model. Linking through to other cloud applications can provide a much more seamless experience than trying to cobble it together in-house.

Cloud computing also allows for economies of scale.

Q. What trends are you seeing in global outsourcing, in terms of adoption of middle-office and back-office services? And how is the desire

for transparency affecting the push to outsource?

GATELY: Fund managers are more willing to talk about solutions in middle-office outsourcing, driven by the onus of regulation and as managers seek to keep up with regulatory changes.

Managers, now more than ever, want to focus on the core of their business, which is generating returns for their clients.

Companies planning to expand their businesses want to do so in the shortest time possible. That means managers are refocusing on the most strategic parts of their business. Ten years ago, they might have said the middle-office is off limits, but that's shifted to where fund managers are willing to broaden the discussion.

As for transparency, this is such an important issue. We're investing in toolkits we call "dashboards" which provide a direct line of sight into the quality processing of our operations. In some cases, it provides an hour-by-hour view of what's happening in our organization. Transparency brings a clear economic view around our products to clients, and gives them an effective tool for gaining insights into how much it costs to run new products or individual strategies.

LEHNER: Fund managers have historically considered the performance of a strategy. Now, transparency is also allowing them to consider the cost of running it. Firms are taking a hard look at these issues, and we are here to provide a solution set.

JOHN J. LEHNER

As president and CEO of Eagle Investment Systems, John Lehner shapes the vision and sets the strategy to execute Eagle's mission to help the world grow assets efficiently. He has more than 24 years of experience in the financial services technology industry with a unique background spanning both the buy and sell side. Mr. Lehner joined Eagle in 2000 with the initial goal of establishing Eagle's global sales and operations. Since that time, his responsibilities have expanded and he has played a key role in developing and growing the other areas of the company.



John Lehner

PAUL GATELY

As Head of Outsourcing at BNY Mellon, Paul Gately brings 25 years of experience in global asset management and related businesses. He has a solid understanding of investment services across a broad range of asset classes for retail, institutional, and high net worth investors, and expertise in developing and implementing business strategies in global financial services.



Paul Gately

BNY Mellon is the corporate brand of The Bank of New York Mellon Corporation and may also be used as a generic term to reference the Corporation as a whole, or its various subsidiaries generally. Products and services may be provided under various brand names, and in various countries by subsidiaries, affiliates and joint ventures of The Bank of New York Mellon Corporation where authorized and regulated as required within each jurisdiction, and may include The Bank of New York Mellon, One Wall Street, New York, New York 10286, a banking corporation organized and existing pursuant to the laws of the State of New York (member FDIC), and operating in England through its branch at One Canada Square, London E14 5 AL, England, registered in England and Wales with FCOO5522 and BROO0818 and authorized and regulated by the Financial Services Authority in the UK. Not all products and services are offered at all locations.

BNY Mellon assumes no liability whatsoever (direct or consequential or any other form of liability) for any action taken in reliance on the information contained in this article, or for resulting from use of this article, its content, or services. Any unauthorized use of material contained in this article is at the user's own risk. Reproduction, distribution, republication, and retransmission of material contained in this article is prohibited without the prior consent of BNY Mellon.

The views expressed within this article are those of the contributors, only and not those of BNY Mellon or any of its subsidiaries or affiliates.

People & Funds

SEC's Karpati Joins Pru As Funds, Boards CCO

Bruce Karpati, chief of the asset management unit in the **Securities and Exchange Commission's** Enforcement Division, left the agency in May to become chief compliance officer for **Prudential Investments**, the mutual fund manufacturing and distribution business of **Prudential Financial**. In addition to leading compliance for Prudential's registered investment advisory company, Karpati will be the CCO for its mutual funds boards.



Bruce Karpati

Karpati led the asset management unit from its creation in January 2010 as one of five specialist teams within the Enforcement Division. In that role, he oversaw investigations of investment advisors for various forms of misconduct involving valuation, performance, conflicts of interest, insider trading, manipulation, derivatives, fund governance, the 15(c) process, disclosure and

compliance and controls.

He also led several risk-based initiatives to identify wrongdoing by advisors, including the aberrational performance inquiry (*FD*, March 2012), fund fee initiative, revenue sharing initiative and compliance program initiative—the last of which focuses on registered advisors that repeatedly fail to adopt or implement effective compliance programs.

Karpati joined the SEC's New York regional office as an enforcement staff attorney in 2000. Following his departure, deputy chiefs **Julie Riewe** and **Marshall Sprung** will lead the unit until new leadership is named, the SEC said in a statement.

"[Karpati's] unparalleled, intimate knowledge of issues that affect mutual fund companies and investors—from valuation, disclosure, mutual fund board governance and other controls—will be invaluable to our business as we seek to offer investment options that provide the best potential for investors to meet their financial goals," said **Lee Augsburger**, Prudential Financial's chief ethics and compliance officer, in a statement.

New Series Trust, Board Enter The Market

A new player has entered the series trust business and will be overseen by a diverse board with "good business judgment" but no specific financial markets expertise. **Andres Sandate**, president and ceo of Atlanta-based **Endurance Fund Services**, which is sponsoring the trust, said the four independent directors are accessible and take their role as fiduciaries seriously. "It's not a rubber stamp board," he told *FD*.

The **Endurance Series Trust** board is comprised of independent directors **Rhett Ingerick**, 38, a software developer; **Bevin Newton**, 42, a choreographer and ballet teacher who has held management positions in the corporate world; **Brad Olecki**, 34, a sales executive in the sports industry; and **Michael Parks**, 34, a logistics supervisor. Interested Chairman **Derek Pilecki**, 42, is a managing partner and portfolio manager at **Gator Capital Management** in Tampa, Fla. Sandate said the trust sponsor did not use a search firm to populate the board but did seek advice from counsel. He maintained that the "fresh" perspective of individuals

who are not industry insiders will be beneficial to the advisors entering the '40 Act space for the first time and to shareholders.

The trust has launched its first fund, the small-cap *Gator Focus Fund* from Gator Capital Management, and expects to add another two to three before year's end. The number of funds in the trust will be capped at between 10 and 20, Sandate said. Both the sponsor and the board are cognizant of the recent regulatory scrutiny of series trusts (*FD*, June 2012) and have been following the case against the board of two **Northern Lights** series trusts (*see story, page 1*), Sandate said, explaining that capping the number of funds in the trust is a way to ensure good governance and oversight. "Our board is very attuned to what is going on [and] we don't want to have a trust that becomes too big—in terms of number of advisors and number of funds—that no individual could do a proper job, in terms of the trustees," he said.

Each independent trustee will be paid \$1,000 per fund annually, plus \$500 per meeting attended in person and \$250 per meeting attended by telephone. Sandate said the board is scheduled to meet quarterly.

Investment Company Institute 2013 General Membership Meeting

ICI GMM Covers Wide Swath Of Issues

Some 1,430 industry professionals packed the **Marriott Wardman Hotel** in Washington, D.C., on May 1-3 for the **Investment Company Institute's 2013 General Membership Meeting**. Following are some highlights from the three-day event:

Use Social Media, Games To Engage Youngsters

Mutual fund firms have a responsibility to get the younger generation to save, and social media, digital games, and virtual competitions can help target that audience, according to fund executives on the Leadership Panel Thursday morning. Digital communication is the way the younger generation interacts, yet some fund firms have abstained from using these mediums, **Alan Reid**, president and ceo of **Forward Funds**, said. "The industry has sort of given in and said, 'Because of regulation we can't do it,'" he said. **Elizabeth Corley**, global ceo of **Allianz Global Investors**, added that in a German study where participants were given financial advice using different types of digital graphics, the ones that engaged participants most were games and competitions. "The way we use digitization and social media is so information-rich, but when engaging the younger generation, we need very new ways to find what interests them."

Risk Perspective Different For Younger Investors

While technology and social media are important parts of attracting younger investors, asset managers also need to tailor their approach to meet a different risk perspective, executives said during a Friday morning session. The panelists cautioned against categorizing 20- to 40-year-olds as risk-averse because they have lived through at least two economic downturns. "We have to be careful not to say that their risk tolerance is different, but their experience is different," said **John Thiel**, head of Merrill Lynch wealth management at **Bank of America Merrill Lynch**. "They come in with a general mistrust about what's possible. But so would we if the

first 11 years of our adult life we didn't make any money in equities." He added that investors in this age group are very willing to accept advice but advisors need to be more diligent and prove that their recommendations are worthwhile. "They're not going to take your word for it," he said. **Patrick O'Connell**, executive v.p. of **Ameriprise Advisor Group**, added: "Those people do have a different perspective on risk-tolerance, but the ways you go about accumulating wealth today are very similar and the work we do with our advisors is back to the fundamentals—systematic savings, dollar-cost averaging and a diversified portfolio."

Could This Be China's Century?

Asset managers still can make money in China from a long-term, balanced approach, despite its risks, volatility, ageing population and potential political unrest. China's problems are the flipside of its opportunities, according to **Lloyd Blankfein**, chairman and ceo of **Goldman Sachs**, who addressed the conference during lunch on Thursday. "The 20th century was America's century," he said. "I can't tell you whether this is China's year or not, but I really believe that this could be their century. That [ageing] population means that they are going to have to go out and create social services, which means they will have to create pools of capital. As companies go to the outside world and issue their debt and issue their equity on the Hong Kong market, they will build out bigger equity markets to create the securities and pools of capital in China that will fund Chinese growth." **George Ding**, ceo of Chinese firm **Hua An Funds**, said during a session following lunch that investing in fixed income and equity will pay off. He explained that in a low-yield environment, treasury rates on the long end in China hover around 3%. Added to currency appreciation at 2%, investors will get returns around 5%. Decreasing credit quality will result in even greater returns, Ding added. On the equity side, buy-and-hold strategies won't work, and active managers may have the most to gain. **Peter Alexander**, principal at **Z-Ben Advisors**, advised investors to take a cautious approach. "You can make money in China," he said. "But there needs to be a balanced approach because the risks aren't going anywhere."

IDC Members Focus On Valuation

Discussions of fair value dominated the **Independent Directors Council's 2013 Fund Directors Workshop**, which ran concurrently to the *2013 General Membership Meeting* sessions. While the closed-to-the-press program featured other topics—such as oversight of portfolio performance and omnibus subaccounts—the **Securities and Exchange Commission's** case against the **Morgan Keegan** funds board (*FD*, 4/8) elevated valuation to top-of-mind.

According to one independent director who sat in on the IDC sessions, “you could not turn around or say hello to anybody at that meeting without hearing about valuation.” During breakout sessions, directors discussed how their own boards and advisors handle fair value and compared practices and policies. “It was interesting in that it demonstrated—not unusually—a wide range of practices by people who are taking all

of this seriously,” one director told *FD*. “There were a number of different approaches, every one as legitimate or valid as the next.”

There was no sense that boards or advisors are making radical changes to their valuation policies and procedures. Rather, they are revisiting how they handle valuation. “You should definitely have it on your to-do list,” one director said. “And maybe counsel is more involved.”

More generally, directors discussed the SEC's approach to boards. “The concern about how the SEC seems to be going after directors on issues with enforcement actions rather than rule or guidance issuance is very real—to the point that I heard some directors refused to discuss valuation issues with the SEC on advice of counsel,” one director reported.

One final issue that drew attention was that of setting a mandatory retirement age for a board. Not surprisingly, this topic drew a diversity of opinions but consensus that there is “no good answer.”



Reporter's Notebook

Tidbits collected here and there around the Investment Company Institute's 2013 General Membership Meeting in Washington, D.C.

The American Spirit

America is the land of opportunity. Life should be “better and richer and fuller for everyone,” right? **Alan Reid**, president and ceo of **Forward Funds**, sure thinks so—and he believes that ethos should carry into investing. “Indexing is positively un-American. What you're saying is, ‘I want to be just a little bit below average,’” he said during a Thursday morning panel. He later scolded the press for over-reporting and over-tweeting his comment, maintaining that discussing 401(k)s should be a higher priority.

A Step Up

As is tradition, the final morning of the conference was devoted to regulatory issues, and **Securities and Exchange Commission** Chairman **Mary Jo White** bravely took the stage just 18 days after assuming her new role. She said nothing earth-shattering and took no questions from the audience, but she did gamely poke fun at herself for having to stand on a box in order to see over the podium. Don't be fooled by her diminutive stature, however—her personality seems plenty big enough to compensate for her elfin appearance.

Eating Jamie's Lunch

Goldman Sachs Chairman and CEO **Lloyd Blankfein** was treated to lunch on Thursday by none other than **Jamie Dimon's** firm, **JPMorgan**. As Blankfein sat comfortably on the stage under a banner announcing JPMorgan's sponsorship, he noted the irony: “No one tell Jamie I'm eating his lunch; it gets him upset.”

Please, No More Tribute Bands!

ICI conference planners outdid themselves on the tribute band front this year with **Super Diamond**, an ode to legendary singer/songwriter **Neil Diamond**. (Please read previous statement with a sarcastic tone.) Aren't tribute bands more appropriate when the object of the tribute has gone on to greener pastures and therefore can't be enjoyed live anymore? Neil Diamond is still kicking around. In fact, he appeared just a week beforehand at **Fenway Park** to serenade **Red Sox** fans in the wake of the Boston Marathon bombing. In all seriousness, though, the fund industry wants something different next year after years of tributes to past-their-prime and long-dead performers. Put your thinking caps on, ICI, and wow us in 2014!

Learning Curve

Mandatory Retirement: Considerations for Retiring Directors

By *Rajib Chanda and Jimena Acuña Smith, Ropes & Gray*



Jimena Acuña Smith



Rajib Chanda

Close to 70% of mutual fund boards have formally adopted mandatory retirement policies for directors that require them to step down at a specified time—for example, by the end of the calendar year in which a certain age is reached.¹ There has been much discussion of the advantages and disadvantages of having a mandatory retirement age (for example, the benefits of the influx of new ideas and perspectives versus the benefits of experience and institutional memory).

This article does not seek to revisit those arguments. Instead, it focuses on (a) considerations with respect to the timing of retirement and (b) the duties and obligations of director emeriti, who may have the designation of retired director for decades following the end of their service on a mutual fund board.

No regulatory requirement exists relating to director retirement policies and, though the **Investment Company Institute's** *Best Practices Report* recommends that mutual fund boards adopt policies governing director retirement, the report declines to state a preference for a particular type of policy (e.g., a mandatory retirement age policy versus term limits on the service of mutual fund directors).² For those directors sitting on the boards of mutual funds that have adopted mandatory retirement age policies, the average mandatory retirement age was reported to be approximately 72 years old in 2012.³

Timing Matters

In our experience, most mandatory retirement age policies specify that a director must retire by the end of the calendar year in which he or she attains a threshold age. While this typically is unproblematic, a question for consideration may arise when an independent director's

retirement results in a board where less than two-thirds of its members have been elected directly by shareholders, as required by Section 16 of the Investment Company Act of 1940, as amended (the "1940 Act"). In such circumstances, a shareholder meeting will need to be convened for the election of directors by shareholders.

If a shareholder meeting is required, depending on applicable state law, it is possible that a retiring director's term will end on the date of the shareholder meeting, and not the last day of the calendar year (assuming the meeting is not held on Dec. 31). Thus, the question that arises is whether to put a retiring director up for re-election, along with a new director nominee, such that the retiring director may serve out the remainder of his or her term, or wait until the vacancy occurs and then hold a shareholder meeting to fill the vacancy.⁴ Board size is often the product of thoughtful consideration, however, and boards may not want to operate with one fewer member than desired for any length of time. Alternatively, a board simply could determine to have the retiring director's term end earlier than Dec. 31, such as on the date of the shareholder meeting.

Because some directors may be asked to step down from the board earlier than expected merely because their retirement triggers a vote due to Section 16 of the 1940 Act, many boards perceive this result as inequitably limiting certain board members' tenure on the board. Some boards, however, may deem this not to be an issue under the theory that, in the abstract, any particular director is as likely as any other to be the director whose vacancy results in the requirement for

¹ 2011 Directors Practices Study: Practices and Compensation, Report to Participants, Investment Company Institute (Revised Sept. 2011).

² John J. Brennan et al., Report of the Advisory Group on Best Practices for Fund Directors: Enhancing a Culture of Independence and Effectiveness (1999).

³ Mutual Fund Director Compensation: The 2012 MPI Annual Survey, Mutual Fund Directors Forum Webinar (May 15, 2012), http://www.mfdf.org/events/event/Director_Compensation/ (finding that, as of 2012, the average mandatory retirement age for those boards that have adopted mandatory retirement age policies is 72 years old); see also 2011 Directors Practices Study, *supra* note 1 (finding that, as of 2011, the average mandatory retirement age for those boards that have adopted mandatory retirement age policies is 74 years old).

⁴ Typically, boards are submitted as a "slate" of nominees rather than each individual director being submitted for election.

Fund Director Intelligence

Timely briefings on Governance and Compliance for Fund Trustees

prepare

Use **Fund Director Intelligence** to set the agenda for your next board meeting.

Plan

Through timely, practical insight, **Fund Director Intelligence** empowers trustees with what they need to know now and what to expect in the future.

Compete

Fund Director Intelligence provides not only the facts on mutual fund governance and regulation, but also a clear understanding of the impact they will have on the board.

Advance

News, features, insight and commentary provide exclusive intelligence on mutual fund industry oversight.

Connect

Find out what your industry is thinking, get first hand perspectives and connect with key industry participants.

www.FundDirectorIntelligence.com

“Fund Director Intelligence is tireless in its efforts to report on issues and opinions that are important for the industry and is persistent in getting the story out. For directors who want to stay informed, it’s an essential resource.”

Robert Bremner, Independent Chairman
Nuveen Funds



To find out more about your subscription options or to set up a trial please contact John Diaz at (212) 224 - 3366 or jdiaz@iintelligence.com.

a shareholder vote. While that is certainly a reasonable approach, it may be one worth discussing among the board in advance of the issue arising.

If a board does choose to address this issue, it may do so in one of at least three ways. First, as noted above, it may choose to retain the retiring director as an “extra” director through the end of the year, meaning that the retiring director would be re-elected at the shareholder meeting but would then be expected to retire at the end of the calendar year. Second, the retiring director could be placed on an “advisory board” or in another consulting role through the end of his or her expected term. Third, the board could determine to otherwise consult the director (and compensate the director for services) through the end of the calendar year in which his or her service was expected to end. All of these “solutions” would need, of course, to be consistent with the fiduciary duties of the directors to the shareholders of the funds they oversee, and thus should be grounded not simply upon fairness to the retiring director but also upon the value of the oversight provided by the retiring director.

Continuing Duties, Liabilities, Obligations

In addition to considerations with respect to timing, retiring directors should be mindful of their continuing duty of confidentiality to the funds they oversaw and potential related liabilities and obligations.

With respect to confidentiality, retiring directors of mutual fund boards should be aware that they have a continuing duty of confidentiality with respect to any non-public information to which they may have been made privy or otherwise received—such as in the form of board materials or electronic communications—while serving on the board. For the immediate periods after a director’s tenure ends, the director may still be in possession of material non-public information about the investment advisor to a fund or particular portfolio investments made by the funds, and the director remains subject to insider trading and other federal securities laws. If a retired director receives a communication in error that appears to contain non-public information, the director should notify both the sender and counsel to the mutual fund complex, as appropriate under the circumstances. For periods well after a director’s tenure ends, moreover, the director may still possess certain information, the

revelation of which could result in breach of boardroom confidentiality or unauthorized waiver of the attorney-client privilege. Thus, it is best practice to assume that all matters that were communicated to directors in confidence during their tenure on the board should remain confidential in perpetuity.

With respect to liability, directors are keenly aware that they may be held liable for acts or omissions that occurred during their tenure on the board. For example, shareholders may bring derivative claims against a director, alleging that the director’s harmful conduct while in office caused harm to the fund, often years after a director’s service has ended. Even if a director is not the subject of such derivative claims, he or she may be called upon to serve as a witness or to provide documents or testimony. Consistent with applicable state law, provisions of the 1940 Act and the regulations and other authority promulgated by the **Securities and Exchange Commission** thereunder, a mutual fund’s governing documents typically provide for material indemnification protections to both current and former directors, unless the director engaged in willful misfeasance, bad faith, gross negligence or reckless disregard of his or her duties as director. A mutual fund complex also may extend or clarify the indemnification protections (for example, with respect to advancement of expenses) for directors pursuant to separate indemnification agreements between the director and the mutual fund. Retired directors typically are covered to the same extent as current directors under any such agreement, the fund’s governing documents, and directors’ and officers’ errors and omissions insurance policy. To the extent that retired directors are not clearly covered, the board may want to consider whether amendments to such agreements, documents or policies are appropriate.

Given the potential liability for a retired director relating to actions taken while on the board, or the potential for such a director to serve as a witness or to provide testimony, boards also may want to have a practice with respect to the review and approval of the final minutes of a board meeting attended by a retiring director. In many cases, when a director retires, he or she is not given an opportunity to comment on the minutes of the last meeting he or she attended. Since those minutes are the record of the meeting that is most likely to form the basis of questioning in the event of a

dispute, some boards maintain a practice of allowing the retired director to comment on the final set of minutes; other boards choose not to do so, for a variety of reasons.

In addition to the considerations outlined above, a mutual fund may have other policies and procedures by which a retiring director remains bound, such as policies concerning the disposal and retention of documents related to the business affairs of the fund. Subject to certain exceptions, a retiring director may be required, for example, to dispose of all board materials, electronic communications or other documents received, created or annotated relating to the operations of the fund. In certain circumstances, a retiring director may instead be required to retain documents for possible production in connection with

litigation or regulatory proceedings. When crafting such policies relating to directors, it is useful to consider the application of the policies to retiring or retired directors.

For any board with a mandatory retirement policy, the hope is that retired directors will live long, healthy lives for decades after their retirement date. A little forethought by mutual fund boards regarding the timing of retirement and the duties, liabilities and obligations of retired directors can help ease a director's transition into retirement.

Rajib Chanda is a partner focusing on investment management and securities law. **Jimena Acuña Smith** is an associate in the Corporate Department focusing on investment management.

News Briefs

The monthly news briefs are a summary of publicly reported mutual fund news. The information has been obtained from sources believed to be reliable, but *FD* does not guarantee its completeness or accuracy.

Regulatory

- Regulators have given themselves until September to try to resolve differences over how to supervise derivatives, according to **Brian Bussey**, associate director for derivatives policy at the **Securities and Exchange Commission**. (Reuters, 5/15)
- SEC Member **Daniel Gallagher** said the agency's chairman, **Mary Jo White**, agrees with calls for a broad review of the framework of the U.S. equity market, which has been roiled by software problems over the past year. (Reuters, 5/14)
- White has defended the agency's policy of letting firms settle civil charges without admitting or denying them—but also pledged to review the practice, which has been criticized by some federal judges and lawmakers who argue the SEC should insist on an admission of guilt. (Reuters, 5/7)

Funds & Firms

- The **iPath S&P 500 VIX Short Term Futures Exchange-Traded Note** has taken in \$855.3 million in inflows this year, accounting for much of the growth in the U.S.-listed alternative exchange-traded funds. U.S.-listed ETFs have taken in more than \$83 billion so far this year.

(IndexUniverse, 5/24)

- The investment advisor behind the **QuantShares** family of exchange-traded funds, **FFCM**, has agreed to be bought by **Mosaic Investment Partners**. The company's four ETFs have \$22 million in assets. (IndexUniverse, 5/22)
- **BlackRock** and **Western Asset Management** have started bond funds designed to work like money funds as regulators get set to impose changes to the industry. The new "ultra-short" funds have share prices that fluctuate along with the value of their holdings, rather than a fixed net asset value. (Bloomberg, 5/16)
- **Fidelity Investments** has received approval from the **Securities and Exchange Commission** to market actively managed exchange-traded funds. Its first planned active fund was the *Fidelity Corporate Bond ETF*. (IndexUniverse, 5/14)

People

- President **Barack Obama** has nominated two U.S. Senate aides to serve as members of the **Securities and Exchange Commission**. Obama said **Kara Stein**, an aide to Sen. **Jack Reed** (D-R.I.), would replace SEC Democratic Commissioner **Elisse Walter Michael**

Piowar, an economist who works for the Senate Banking Committee, would replace SEC Republican Commissioner **Troy Paredes**, whose term is set to expire in June. The Senate must approve the nominations. (Reuters, 5/24)

- **Legg Mason** portfolio manager **Mary Chris Gray** has left as her unit was folded into the firm's **ClearBridge Investments** equity affiliate. **Randy Befumo**, head of research at **Legg Mason Capital Management**, also left last month. (Bloomberg, 5/22)

- Former senator **Judd Gregg** has been named ceo of the **Securities Industry and Financial Markets Association**. A uniform fiduciary standard will be the new ceo's first priority. (PlanAdviser, 5/20)

- **Securities and Exchange Commission** Chair **Mary Jo White** has chosen **Keith Higgins**, a partner at **Ropes & Gray**, to direct the agency's Division of Corporation Finance, in the latest major personnel change since she took the helm of the agency last month. (Reuters, 5/15)

- Former **BlackRock** fund manager **Mark Lyttleton** was arrested April 30 in West London as part of an insider-trading probe by the **U.K. Financial Conduct Authority**. Lyttleton ran the *BlackRock U.K. Dynamic Fund* and the *BlackRock U.K. Absolute Alpha Fund* until March. (Bloomberg, 5/14)

Industry

- U.S. balanced funds have taken in \$35.2 billion from January to April, according to the **Investment Company Institute**. Assets in the funds increased 3.6%, compared with 1.2% for funds focused only on equities. (Bloomberg, 5/28)
- **Fidelity Investments** said the degree of fear circling bond funds is overblown. **Joanna Bewick**, portfolio manager of the Fidelity Strategic Asset Allocation Funds, said there aren't any near-term catalysts that could send interest rates soaring and cause big losses. (InvestmentNews, 5/23)
- Long-term mutual funds took in \$38.8 billion for the month of April, according to **Morningstar**. Equity inflows were \$895 million, the lowest level this year. (PlanSponsor, 5/16)
- The average exchange-traded fund allocation in advisors' client portfolios is expected to rise 7.8% in 2013, according to **Cerulli Associates**. "Advisor adoption of ETFs continues to be the foundation of growth for the industry," Cerulli Associate Director **Alec Papazian** said. (PlanAdviser, 5/14)
- Target-maturity funds returned 5.3% on average for the first quarter, according to **Morningstar's Ibbotson Associates**. The funds returned 9% for the 12-month period. (PlanSponsor, 5/14)

TRIAL ORDER FORM

www.funddirectorintelligence.com

Yes! Register me for a free trial to **Fund Director Intelligence**, intelligence on governance and compliance for fund trustees.

NAME _____

TITLE _____ FIRM _____

ADDRESS _____

CITY/STATE _____ POSTAL CODE/ZIP _____ COUNTRY _____

TEL _____ FAX _____ E-MAIL _____

The information you provide will be safeguarded by the Euromoney Institutional Investor PLC group, whose subsidiaries may use it to keep you informed of relevant products and services. We occasionally allow reputable companies outside the Euromoney Group to mail details of products which may be of interest to you. As an international group, we may transfer your data on a global basis for the purposes indicated above.

() Please tick if you object to contact by telephone.

() Please tick if you object to contact by email.

() Please tick if you object to contact by fax.

() Please tick if you do not want us to share your information with other reputable businesses.

Tel: 1-212-224-3570
+44 (0) 20-7779-8999
Fax: 1-212-224-3886

Email: hotline@iintelligence.com
Mail: Institutional Investor Intelligence
PO Box 4009, Chesterfield, MO
63006-4009, USA

Fund Director Intelligence
Incorporating Fund Directions

Calendar

- June 9-11: **NICSA** 24th annual Conference on the Globalization of Investment Funds, Boston (508-485-1500)
- June 12-14: **Morningstar** Investment Conference, Chicago (312 696-6050)
- June 13: **Independent Directors Council** Chapter Meeting, Denver (202-326-5800)
- June 18: **Mutual Fund Directors Forum** Conference of Fund Leaders Roundtable, New York (202-507-4488)
- June 20: MFDF Webinar “Trends & Transparency in the Fair Value Process—What Fund Directors Should Know” (202-507-4488)
- June 25: IDC Chapter Meeting, Los Angeles (202-326-5800)
- June 26-27: **Investment Company Institute** Global Retirement Savings Conference, Hong Kong (202-326-5800)
- June 27: IDC Chapter Meeting, San Francisco (202-326-5800)
- July 17: MFDF Director Discussion Series—Open Forum, Kansas City, Mo. (202-507-4488)
- July 25: MFDF Director Discussion Series—Open Forum, New York (202-507-4488)
- Sept. 19: NICSA General Membership Meeting, Boston (508-485-1500)
- Sept. 22-25: ICI 2013 Tax and Accounting Conference, San Antonio (202-326-5800)
- Oct. 2-3: Morningstar ETF Invest Conference, Chicago (312 696-6050)
- Oct. 9: MFDF Board Oversight of Performance, Chicago (202-507-4488)
- Oct. 10: ICI Capital Markets Conference, New York (202-326-5800)
- Oct. 21-23: IDC 2013 Fund Directors Conference, Chicago (202-326-5800)
- Nov 5: ICI Closed-End Fund Conference, New York (202-326-5800)
- Nov. 11: MFDF Conference of Fund Leaders Roundtable, New York (202-507-4488)

- Jan. 28-30, 2014: MFDF 2014 Directors’ Institute, Miami (202-507-4488)
- March 16-19, 2014: ICI Mutual Funds and Investment Management Conference, Grand Lakes, Fla. (202-326-5800)
- April 2-3, 2014: MFDF Policy Conference, Washington, D.C. (202-507-4488)

Quote Of The Month

“No one tell Jamie I’m eating his lunch; it gets him upset.”—**Lloyd Blankfein**, chairman and ceo of **Goldman Sachs**, referring to **JPMorgan** Chairman and CEO **Jamie Dimon**. JPMorgan sponsored the lunch at which Blankfein spoke during the **Investment Company Institute’s 2013 General Membership Meeting** in May (see Reporter’s Notebook, page 14).

One Year Ago In Fund Directions

The **Securities and Exchange Commission** was sharpening its focus on administrator-sponsored trusts, looking in part at whether the trusts’ boards of directors are able to adequately fulfill their fiduciary responsibilities when overseeing large and disparate groups of advisors and funds. [Just a few weeks later, the SEC issued a Wells notice to two **Northern Lights** series trusts for possible 15(c) infractions (*FD*, July) and the regulator has remained focused on the trust structures since. At the beginning of May, the SEC levied charges against the two trusts and announced a settlement at the same time (*see story, page 1*).]

Five Years Ago

Mutual Fund Directors Forum and the **Millstein Center for Corporate Governance and Performance** at the **Yale School of Management** partnered to form a new group for independent chairmen and lead independent directors of mutual fund boards. [The **Conference of Fund Leaders** meets twice annually, in the spring and fall, and is meant to provide members an opportunity to discuss governance issues, present views on policy matters, and promote research into the value and impact of independent leadership at mutual funds.]