ICI INVESTMENT COMPANY INSTITUTE®

IDC Independent Directors Council

Overview of Fund Governance Practices, 1994–2020

OCTOBER 2021

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Key Findings

- **Fund boards, as a group, follow strong governance practices to best serve the interests of shareholders.** Studies of board practices indicate that, over time, fund boards have adopted strong governance practices in advance of, or in the absence of, any regulatory mandate to do so.
- **Independent directors make up three-quarters of boards in 84 percent of fund complexes.** Between 1996 and 2020, the number of complexes reporting that independent directors hold 75 percent or more of board seats rose from 46 percent to 84 percent. Current Securities and Exchange Commission (SEC) rules require only that funds relying on common exemptive rules have boards with a majority of independent directors.
- **More than two-thirds of fund complexes report having an independent chair.** Sixty-eight percent of complexes reported having boards with independent chairs at year-end 2020. When complexes that have boards with lead independent directors are also considered, 93 percent of participating complexes report having an independent director in board leadership at year-end 2020.
- **Boards are increasingly focused on independent director diversity.** There has been a steady increase in the percentage of female fund independent directors, from 20 percent in 2012 to 32 percent in 2020. The increase in the percentage of minority independent directors has been material, but at a slower pace. In 2015, the first year in which race/ethnicity data were collected, the percentage of independent directors identified as a racial/ethnic minority was 8 percent. In 2020, that figure was 12 percent. More recent cohorts of independent directors joining fund boards tend to have increasing percentages of female and minority directors.
- **Almost all complexes report that separate legal counsel serve their independent directors.** The total percentage of complexes reporting that independent directors are represented either by dedicated counsel or by counsel separate from the adviser's has increased over the past decade, from 64 percent in 1998 to 95 percent at year-end 2020. More than half of complexes say that their independent directors retain dedicated counsel—separate from both fund counsel and the adviser's counsel.
- **Most complexes have mandatory retirement policies.** At year-end 2020, 73 percent of complexes have an age-based mandatory retirement policy, 6 percent of complexes have a mandatory retirement policy that entails both a mandatory retirement age and a limit on the number of years a director may serve, and less than 1 percent of complexes limit the number of years a director may serve. For those complexes with an age-based mandatory retirement policy, the average mandatory retirement age is 76. For complexes with a limit on the number of years a director may serve, the average limit is 16 years.

Background

Fund boards perform an important role in the oversight of the fund industry. The Investment Company Act of 1940 (1940 Act) and its related rules impose significant responsibilities on fund boards and dictate elements of board structures and practices. Fund governance practices have evolved, and, in 1995, the Investment Company Institute (ICI) began to document those practices by collecting data from fund complexes biennially.[1] The Independent Directors Council (IDC) was formed in 2004, and, since then, the studies have been conducted jointly by ICI and IDC. This overview provides common fund governance practices covering the period from 1994 through 2020 and is an update to the overview published two years ago.[2] In particular, the most recent study covered 2020, an extraordinary year in which COVID-19 caused fund boards to meet in and adapt quickly to a virtual environment. Notwithstanding the disruptions caused by the pandemic, fund boards continued to work and serve shareholders without interruption.

Though the complexes participating in each biennial study have varied over the years—and some fluctuations in the data may be attributable to those variances—an examination of the data reveals certain trends. To put these data in context, this overview includes information on fund assets managed by complexes that participated in each of the biennial studies, the average fund assets served per director, the average number of funds served, and selected independent director characteristics.

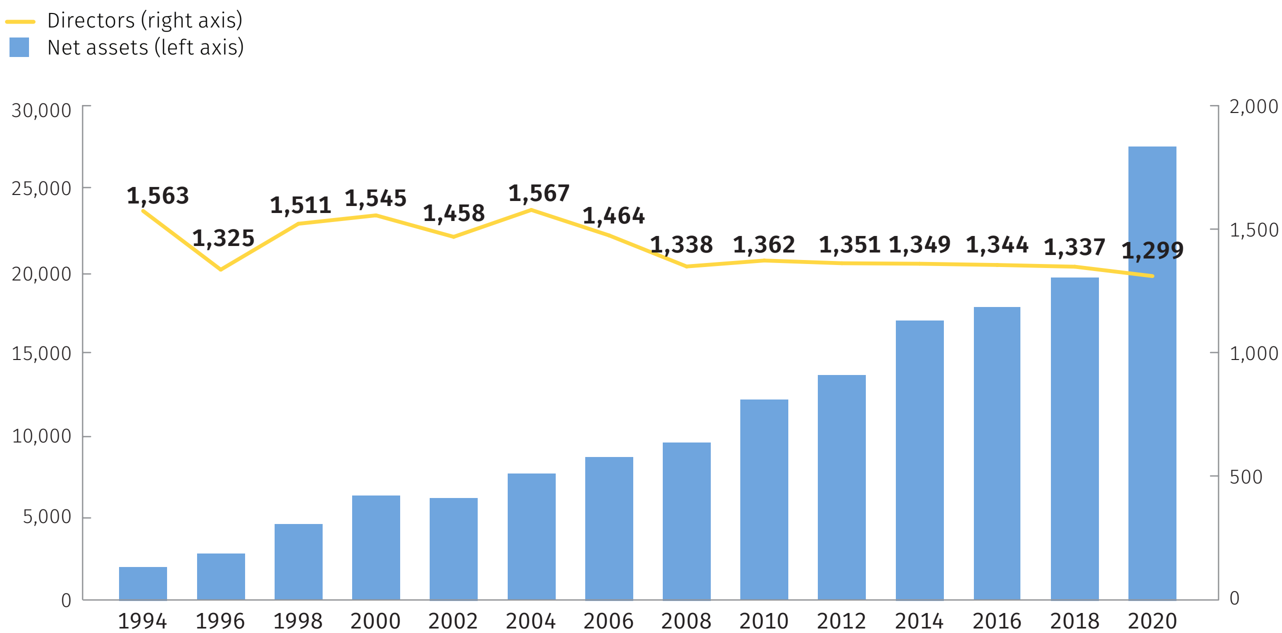
Fund Net Assets and Independent Directors at Participating Complexes

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

FIGURE 1

Total Net Assets and Total Independent Directors at Participating Complexes

Billions of dollars, 1994–2020



Fund Net Assets and Funds Served by Independent Directors

Average fund net assets served by independent directors have increased in each of the studies conducted over the 26-year period (Figure 2). The average number of funds served has increased over time, but remained relatively stable over the past few years (Figure 3).

FIGURE 2

Net Assets Served by Independent Directors

Billions of dollars, 1994–2020

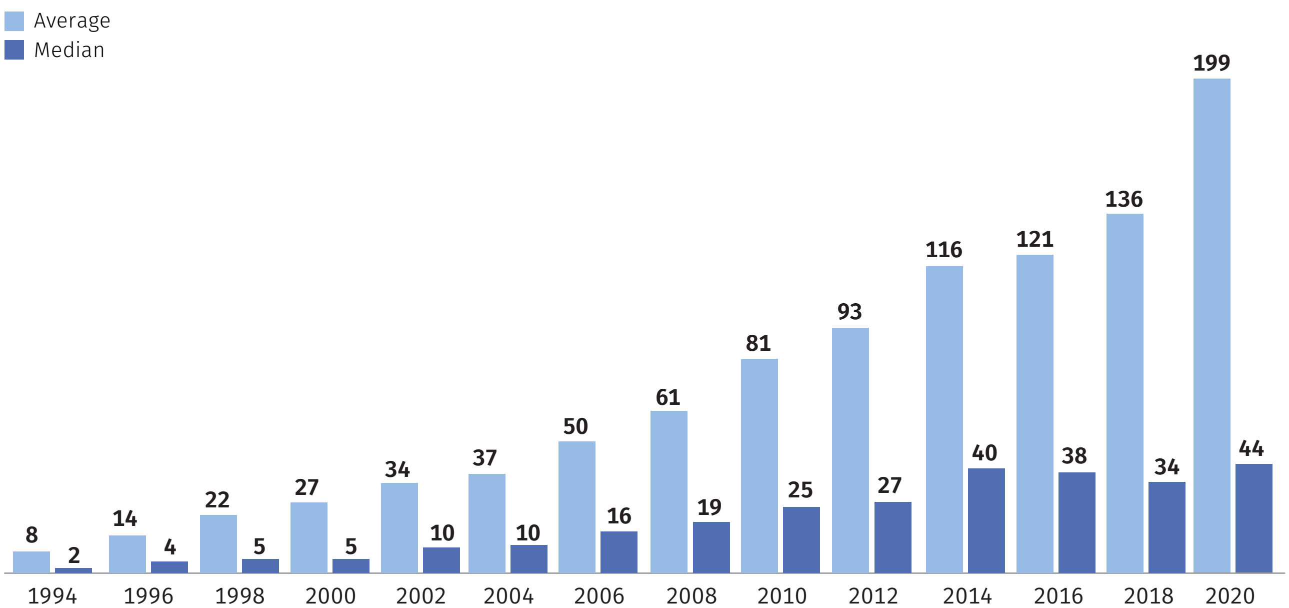
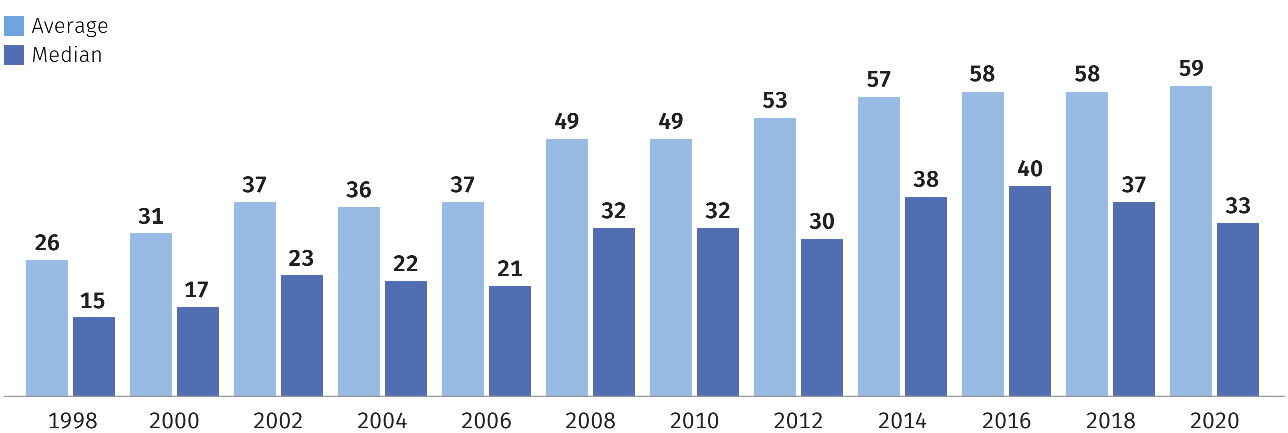


FIGURE 3

Funds Served by Independent Directors

Number of funds, 1998–2020



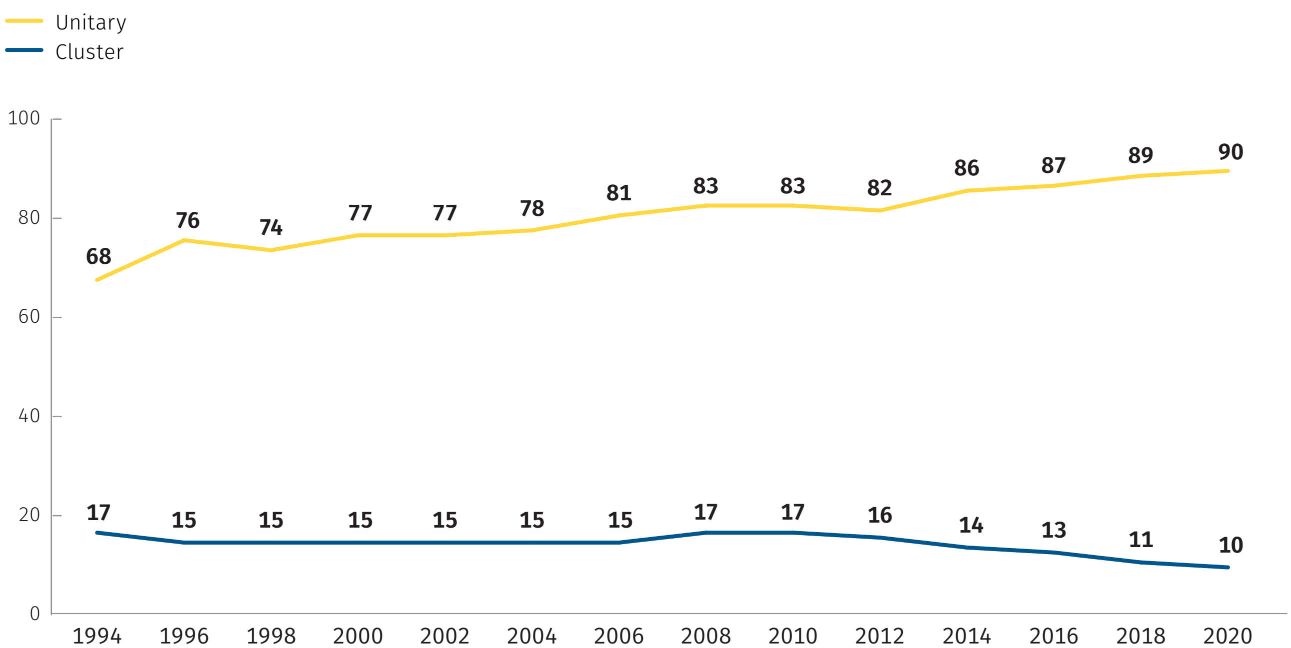
Board Structure: Unitary or Cluster Boards

Since 1994, most complexes have employed a unitary board structure, meaning that a single board oversees all funds in the complex. As of 2020, 90 percent of participating complexes have a unitary board structure (Figure 4). Some complexes, particularly large ones, have adopted a cluster structure, where there are several boards within the complex, each overseeing a designated group of funds. The number and makeup of the clusters may be determined by several factors, including the type of funds (e.g., exchange-traded funds) or whether the funds in a particular cluster were acquired by the complex as a group. The percentage of participating fund complexes using the cluster structure over the last 26 years has declined slightly from around 17 to 10 percent (Figure 4).

FIGURE 4

Board Structure

Percentage of fund complexes, 1994–2020



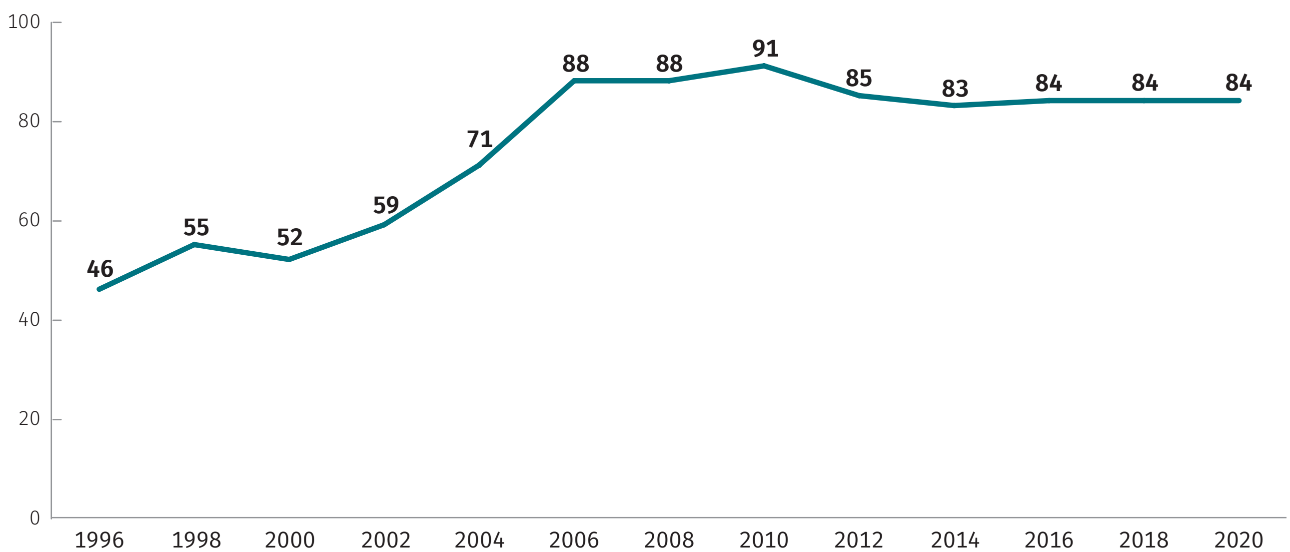
Complexes in Which 75 Percent or More of Board Seats Are Held by Independent Directors

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

FIGURE 5

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

Percentage of complexes, 1996–2020



Number of Independent Directors per Complex and per Board

The number of independent directors in a given complex is influenced by the total number of directors on the board and the number of fund boards at the complex. The average number of independent directors per complex has remained relatively stable over the course of the 26-year period. The median number has ranged from five to seven over the same period (Figure 6). In 2008, the study began reporting the number of independent directors per board (in addition to the number per complex). Since that time, the median and average number of independent directors per board generally has been six (Figure 7).

FIGURE 6

Independent Directors per Complex

1994–2020

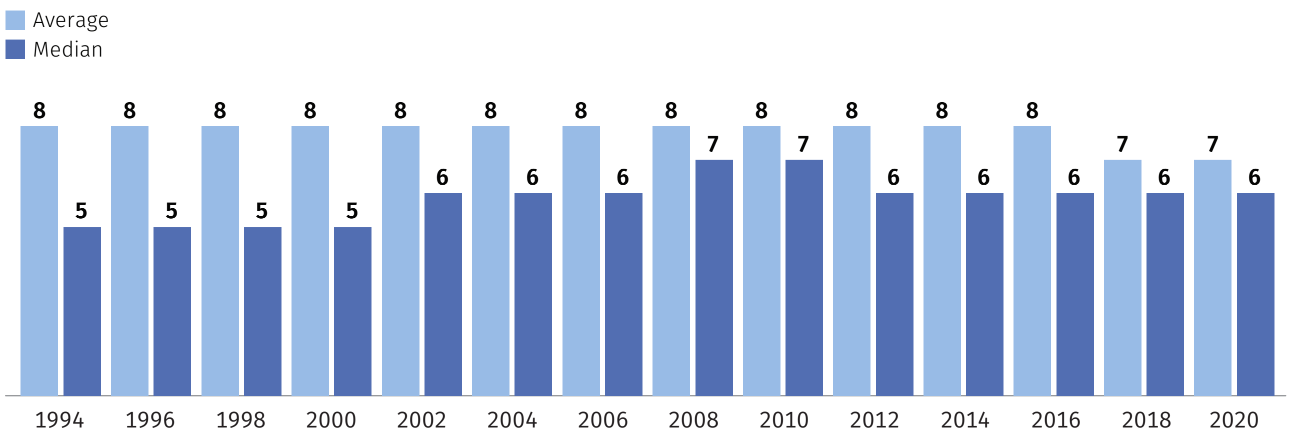
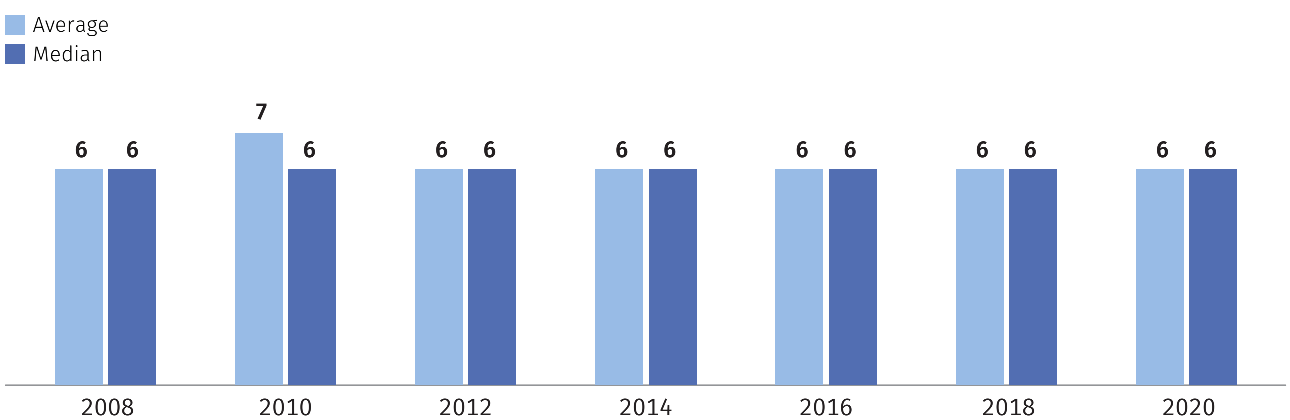


FIGURE 7

Independent Directors per Board

2008–2020



Frequency of Board Meetings

The frequency of regularly scheduled board meetings is not dictated by statute or rule. Approval of the advisory contract, among other duties, normally must occur annually at an in-person meeting. The current study covers a year in which the SEC, in response to COVID-19,[6] granted temporary relief from the in-person voting requirements under specified circumstances.[7] Still, the timing, length, and nature (e.g., in person, telephonic, or videoconference) of the meetings are matters to be determined by each board. The decision on the frequency of meetings may be influenced by several factors, including the size of the board and the number of funds the board oversees. A board may also elect to meet less frequently but for more days each time. Forty-three percent of participating complexes indicate that they held five or more regularly scheduled board meetings in 2020 (Figure 8).

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

FIGURE 8

Regularly Scheduled In-Person Board Meetings per Year

Percentage of complexes, 1994–2020

Year	Four	Five or six	Seven or more
1994	82	5	3
1996	81	12	6
1998	84	10	5
2000	83	10	5
2002	79	14	5
2004	72	20	6
2006	67	26	7
2008	60	34	6
2010	62	30	6
2012	63	27	6
2014	63	28	6
2016	61	30	4
2018	63	30	3
2020*	57	33	10

* For 2020, because of the COVID-19 pandemic, the question changed from "regularly scheduled in person" to "regularly scheduled." Prior years typically do not add to 100 because some small complexes routinely meet by telephone.

Board and Committee Meetings Attended

As noted, a board's regularly scheduled meetings may be augmented by nonscheduled or impromptu meetings. For that reason, since 1998, the studies have included information on the number of board meetings in which independent directors actually participated, in person or by phone or videoconference. The number of board meetings has remained relatively stable over the years, with slight increases in years with turbulent market conditions (e.g., the 2008 financial crisis and the COVID-19 pandemic) (Figure 9).

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

FIGURE 9

Board Meetings Attended

1998–2020

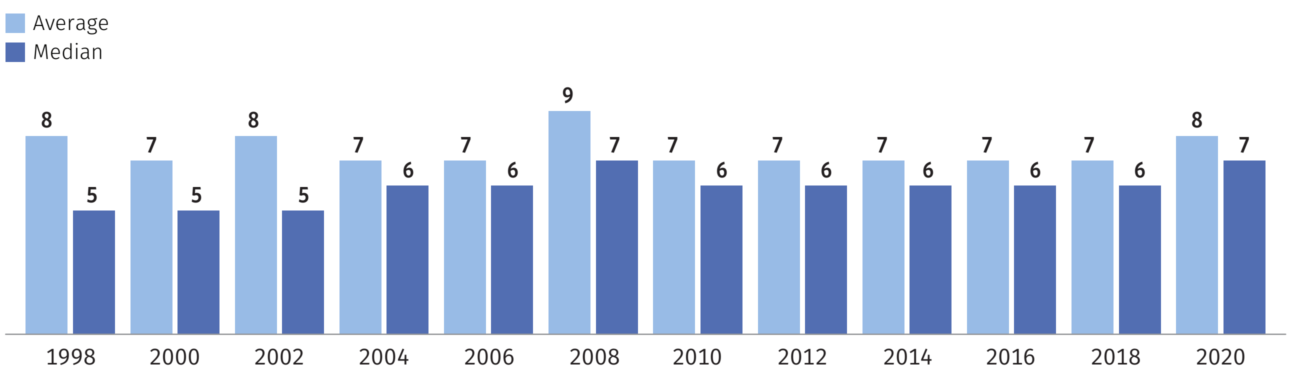
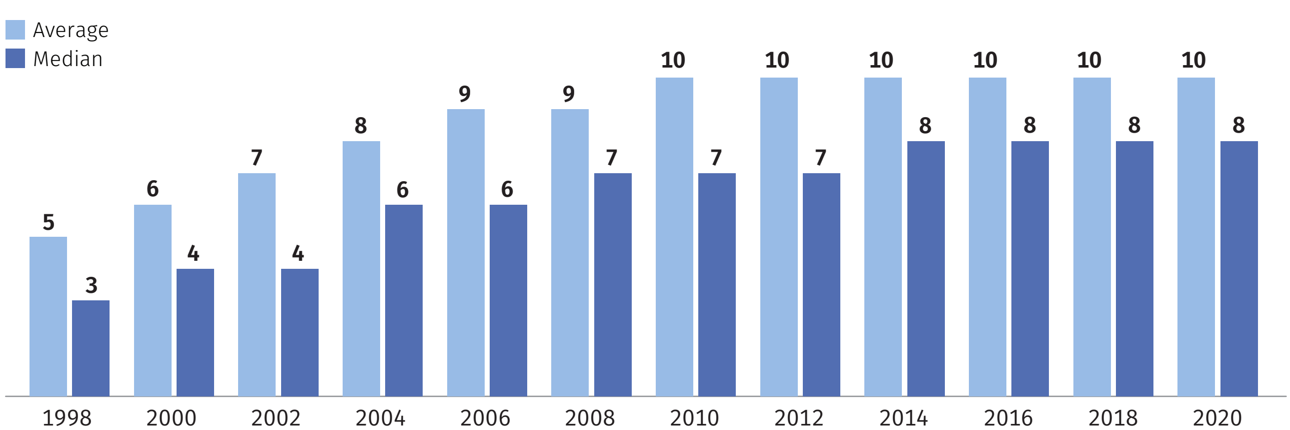


FIGURE 10

Committee Meetings Attended

1998–2020



Independent Chair or Lead Independent Director

Practices relating to independent fund board leadership vary greatly. Some boards elect an independent chair, while other boards designate an independent director to serve as the primary liaison between independent directors and the adviser. Still other boards do not have an independent chair or a lead independent director. Beginning in 1996, survey participants were asked if they had either an independent chair or a lead independent director, but they were not asked to distinguish between the two. The 2004 study, for the first time in the series, collected data separately on the incidence of independent chairs and lead independent directors.[8] In 2020, more than two-thirds of the participating complexes reported that they have an independent chair. As of year-end 2020, 93 percent of participating complexes reported having an independent chair or a lead independent director (Figure 11).[9]

FIGURE 11

Complexes with an Independent Board Chair or Lead Independent Director

Percentage of complexes, 1996–2020

Year	Independent chair	Lead independent director	Either lead independent director or independent chair
1996	n/a	n/a	22
1998	n/a	n/a	26
2000	n/a	n/a	37
2002	n/a	n/a	42
2004	43	18	n/a
2006	56	24	n/a
2008	63	24	n/a
2010	63	25	n/a
2012	62	28	n/a
2014	65	25	n/a
2016	65	29	n/a
2018	66	27	n/a
2020	68	27	n/a

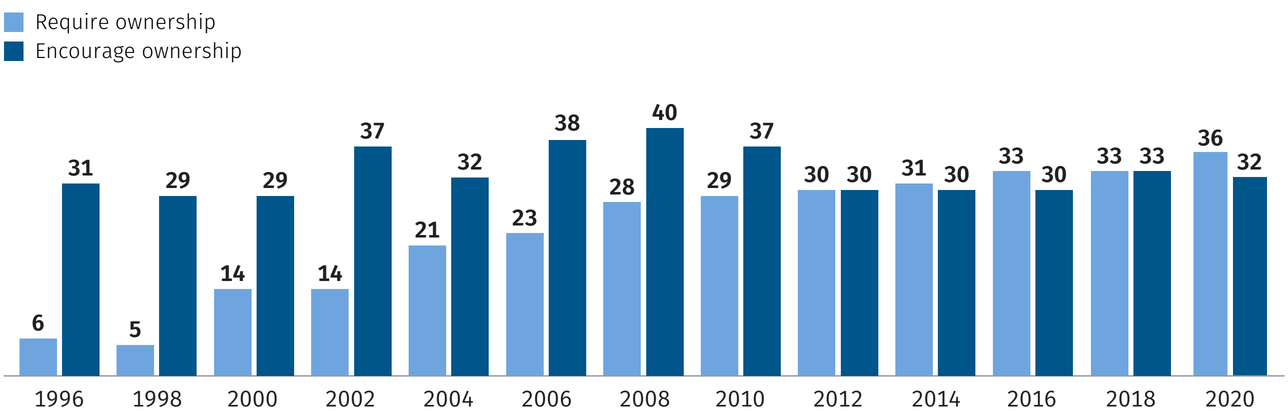
Independent Director Fund Share Ownership

Though many independent directors choose to own shares of the funds they oversee, the practice is not routinely required. This issue attracts some attention because SEC rules require disclosure of fund share ownership by directors. The data indicate that the number of complexes formally requiring fund share ownership by independent directors has increased steadily since 1996 (Figure 12). As of year-end 2020, 36 percent of participating complexes reported that they have a formal policy requiring such fund share ownership and 32 percent of participating complexes encourage, as opposed to require, ownership of fund shares.

FIGURE 12

Share Ownership by Independent Directors

Percentage of complexes, 1996–2020



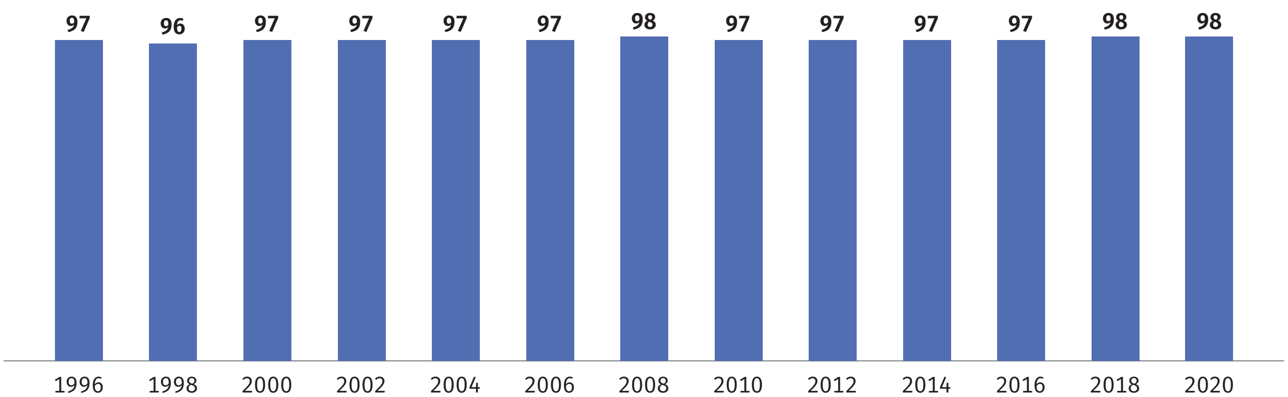
Independent Directors' Prior Affiliation with Complex

The 1940 Act provides that an individual is an "interested person" if he or she has certain personal, financial, or professional relationships with the fund, investment adviser, or principal underwriter. The SEC may also issue an order finding that a director who has had a material business or professional relationship with the fund, adviser, or principal underwriter within the past two fiscal years is an interested person.[10] The data reflect an appreciation for the letter and spirit of the law, as 98 percent of independent directors surveyed report never having been previously employed by the complex (Figure 13).

FIGURE 13

Independent Directors Never Previously Employed by Complex

Percentage of directors, 1996–2020



Director Diversity

Meaningful participation by diverse directors has received increased attention in recent years and has become a priority for many fund boards. In 2012, the study began reporting on the gender of fund independent directors. There has been a steady increase in the overall percentage of female directors, from 20 percent in 2012 to 32 percent in 2020. More recent cohorts of independent directors tend to include a larger percentage of female directors. In 2020, 41 percent of new directors were female, up from 32 percent in 2012 (Figures 14 and 15).

In light of ICI and IDC's goal of collecting and providing diversity data on a regular basis, Figures 14 through 17 present diversity data on an annual rather than biennial basis. As noted, the participants in each annual study vary from year to year, which limits the ability to compare the data between different years.

FIGURE 14

Gender: All Directors

Percentage of directors, 2012–2020

Year	Female	Male
2012	20	80
2013	22	78
2014	22	78
2015	24	76
2016	25	75
2017	27	73
2018	28	72
2019	30	70
2020	32	68

FIGURE 15

Gender: New Directors

Percentage of directors, 2012–2020

Year	Female	Male
2012	32	68
2013	31	69
2014	38	62
2015	39	61
2016	39	61
2017	38	62
2018	43	57
2019	45	55
2020	41	59

In 2015, the study began reporting on the race/ethnicity of fund independent directors. The increase in the percentage of minority independent directors across survey participants has been material, but at a slower pace. In 2015, the first year in which race/ethnicity data were collected, the percentage of independent directors identified as a racial/ethnic minority was 8 percent. In 2020, that figure was 12 percent (Figure 16). Like the trend for female independent directors, more recent cohorts of independent directors tend to have higher percentages of minority directors. The percentage of minority directors joining fund boards in 2020 was 24 percent, up from 8 percent in 2015 (Figure 17). The percentages and trends among different racial/ethnic groups vary significantly.

FIGURE 16

Race/Ethnicity: All Directors

Percentage of directors, 2015–2020

Year	White/ Caucasian	Black/ African American	Hispanic/ Latino	Asian/ Pacific Islander	Other
2015	92	5	1	2	0
2016	92	5	1	2	0
2017	91	5	1	2	1
2018	90	6	1	2	1
2019	89	7	1	2	1
2020	88	8	2	2	0

FIGURE 17

Race/Ethnicity: New Directors

Percentage of directors, 2015–2020

Year	White/ Caucasian	Black/ African American	Hispanic/ Latino	Asian/ Pacific Islander	Other
2015	92	4	0	4	0
2016	91	5	1	1	2
2017	86	6	0	4	4
2018	86	8	3	3	0
2019	78	17	3	1	1
2020	76	16	8	0	0

Mandatory Retirement Policy

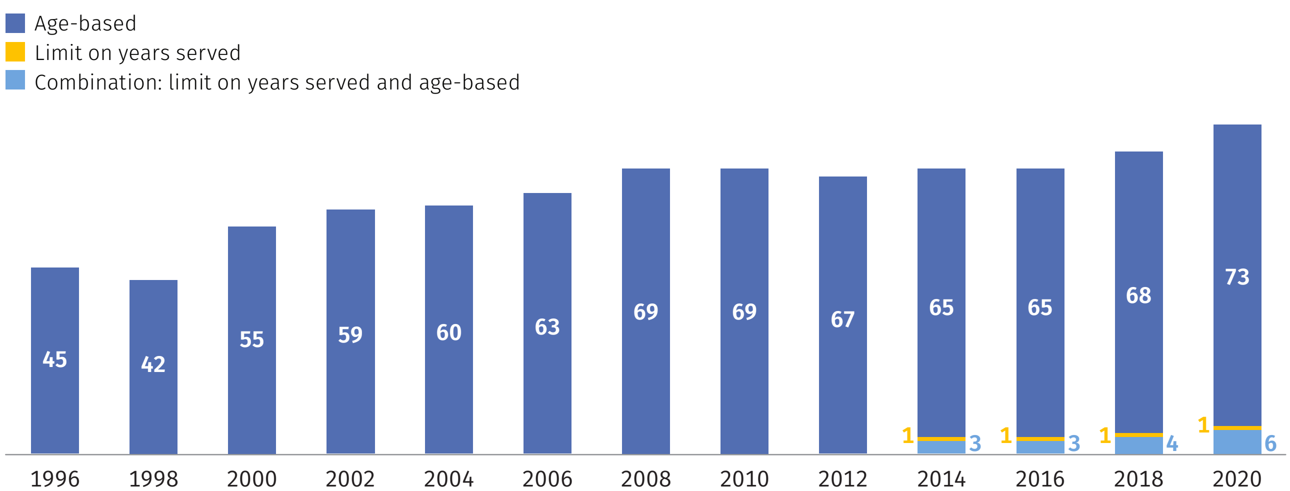
No regulatory requirement relating to retirement policies exists for fund directors, but the topic may be addressed in a board's annual self-assessment. The study has collected data on age-based mandatory retirement policies since 1996. In total, the percentage of complexes that have formally adopted mandatory retirement policies has increased steadily and stood at 79 percent in 2020.

Beginning in 2014, the study collected data on different types of mandatory retirement policies. At year-end 2020, 73 percent of complexes have an age-based mandatory retirement policy, 6 percent of complexes have a mandatory retirement policy that entails both a mandatory retirement age and a limit on the number of years a director may serve, and less than 1 percent of complexes limit the number of years a director may serve (Figure 18).

FIGURE 18

Mandatory Retirement Policy

Percentage of complexes, 1996–2020

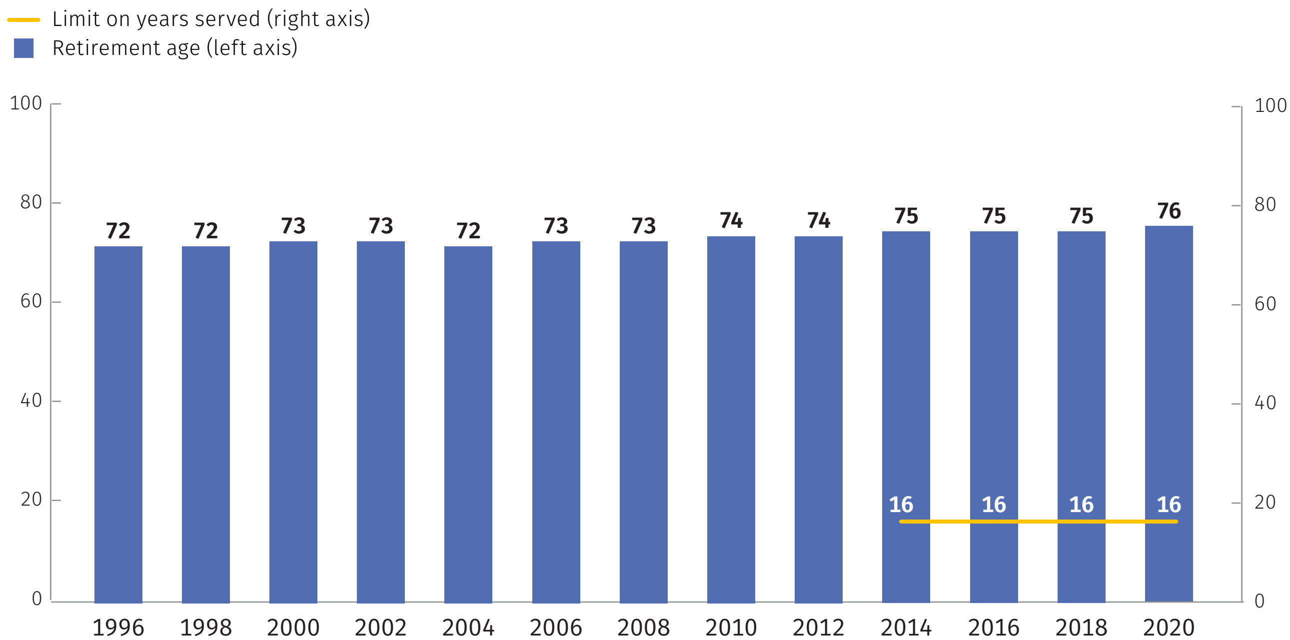


For those complexes with an age-based mandatory retirement policy, the average mandatory retirement age has increased slowly from 72 in 1996 to 76 in 2020. For complexes with a limit on the number of years a director may serve, the average limit is 16 years (Figure 19).

FIGURE 19

Average Mandatory Retirement Age and Average Limit on Years Served

1996–2020



To help put a director's average retirement age in context, previous studies included the age of all independent directors participating in each biennial study and the number of years they had served their complexes as directors. Since 1996, the average age has edged up from 62 to 67 (Figure 17), and the average number of years of service has increased from nine to 12 years (Figure 20).

FIGURE 20

Average Age of Independent Directors

1996–2020

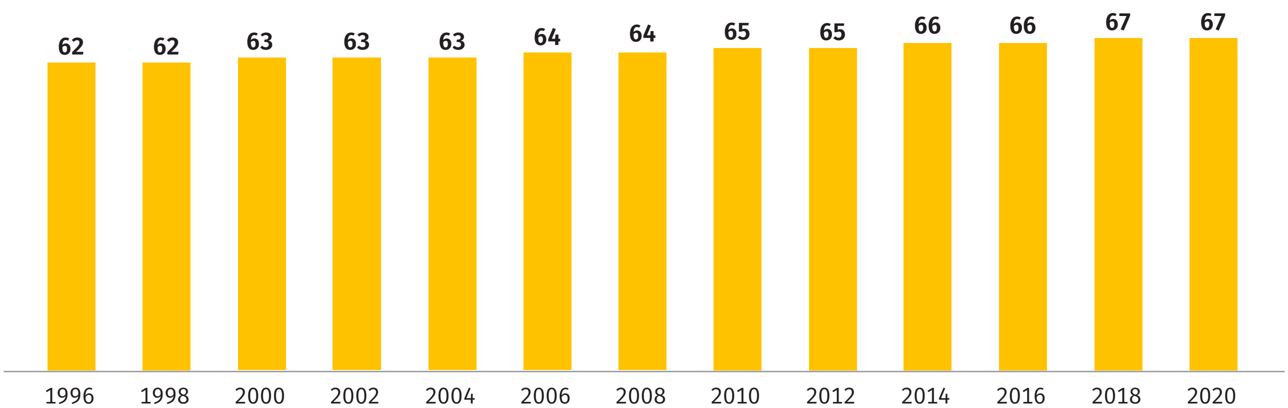
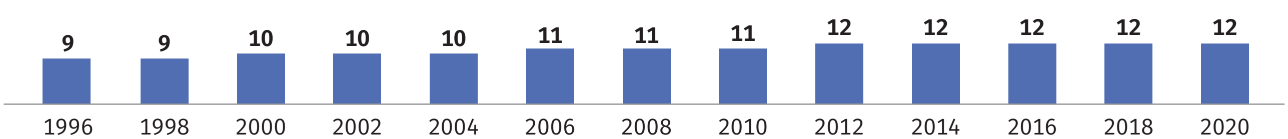


FIGURE 21

Average Length of Service at Complex by Independent Directors

Number of years, 1996–2020



Orientation Programs and Continuing Education

In recognition of the detailed regulation to which investment companies are subject and the extensive duties imposed on fund directors, many fund complexes have been focused on the benefits of orientation for new independent directors and continuing education to help directors stay current on the latest industry and regulatory developments, though neither practice is required. The study began collecting these data in 2010.

As of year-end 2020, 59 percent of fund complexes require new independent directors to complete a formal orientation or education program, up from 21 percent in 2010, and 11 percent of complexes encourage new independent directors to participate in a formal orientation or education program, down from 36 percent in 2010 (Figure 22). As of year-end 2020, independent directors at 15 percent of fund complexes are required to participate in continuing education, up from 9 percent in 2010, and independent directors at 72 percent of complexes are encouraged to participate in continuing education, up from 66 percent in 2010 (Figure 23).

FIGURE 22

Formal Orientation or Education Programs

Percentage of complexes, 2010–2020

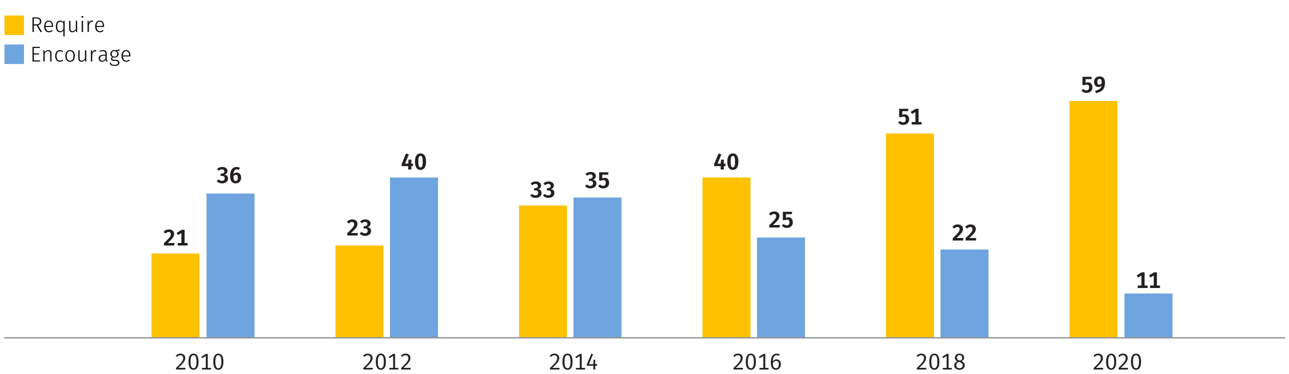
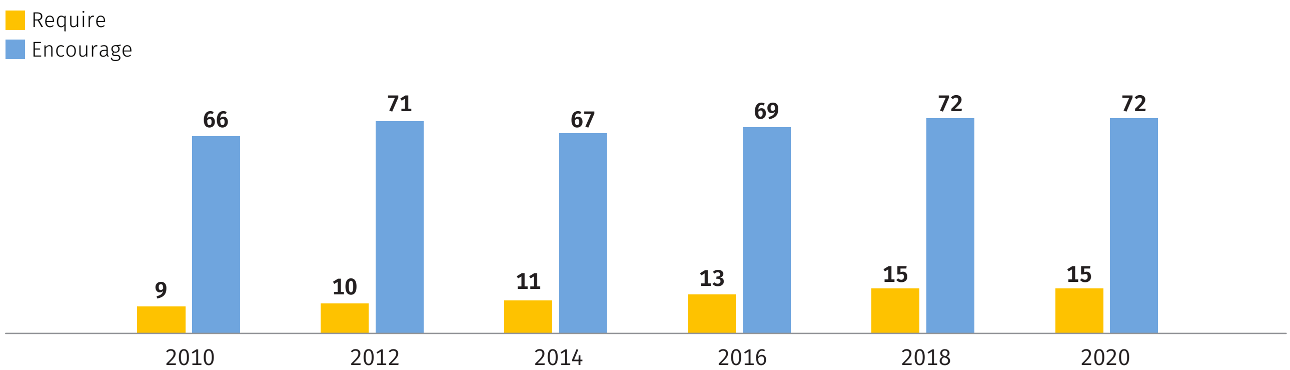


FIGURE 23

Continuing Education

Percentage of complexes, 2010–2020



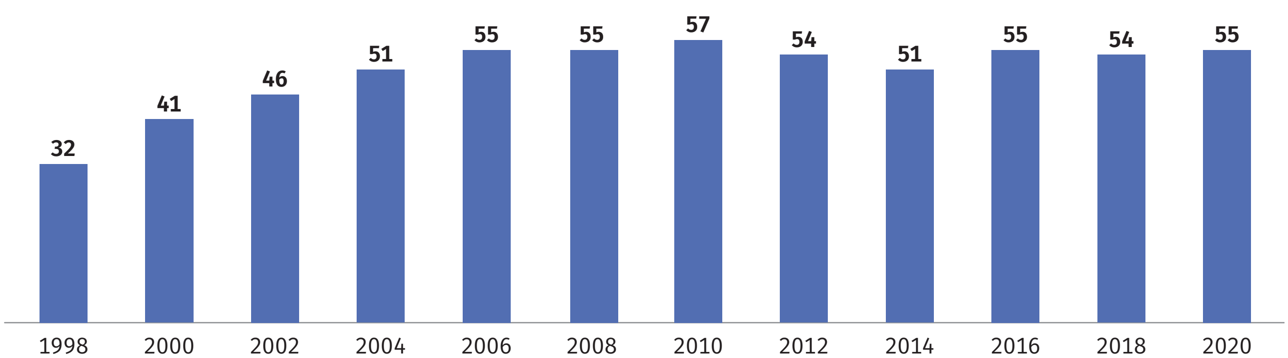
Independent Counsel

Fund boards employ a variety of arrangements in retaining counsel. Some independent directors have their own dedicated counsel, others formally retain counsel with the fund, and still others have no dedicated counsel but instead rely on counsel to the fund (or retain other counsel) on an as-needed basis. The studies have collected data concerning director retention of counsel, and, though the form of the query in the survey questionnaire has varied, certain trends emerge. The data show that instances in which independent directors retain their own counsel—separate from fund counsel and the adviser's counsel—have increased from 32 percent of participating complexes in 1998 to 55 percent in 2020 (Figure 24). These instances include arrangements in which the fund, adviser, and directors are served by different counsel, as well as arrangements in which the fund and adviser share counsel, but the independent directors have separate, dedicated counsel.

FIGURE 24

Independent Directors Have Dedicated Counsel

Percentage of complexes, 1998–2020

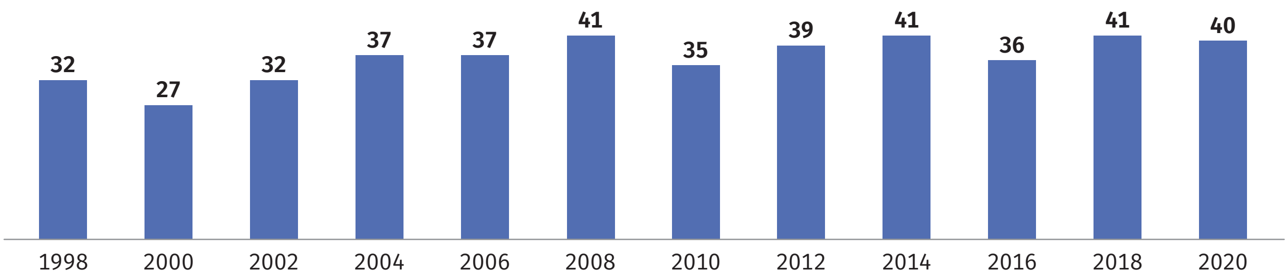


In instances where independent directors formally or informally rely on counsel to the fund while the adviser is served by different counsel, the fund counsel would constitute "independent legal counsel," as defined by SEC rule. In 2020, 40 percent of the complexes reported that independent directors rely on fund counsel (Figure 25). Given the amount of regulatory compliance matters addressed by fund boards, such representation is beneficial to both the independent directors and the shareholders they represent.

FIGURE 25

Independent Directors Rely on Fund Counsel (Different from Adviser's Counsel)

Percentage of complexes, 1998–2020

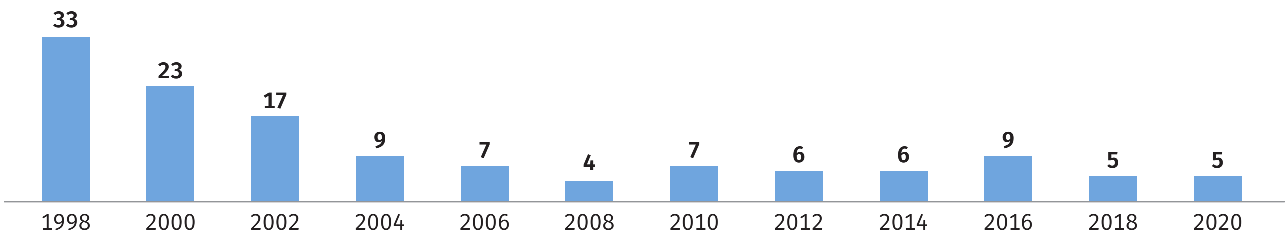


The percentage of complexes indicating that independent directors are not represented by counsel—and are not formally or informally relying on counsel to the fund—declined sharply after 1998 and has held relatively steady since 2004 (Figure 26).

FIGURE 26

Same Counsel Represents Fund and Adviser: Independent Directors Have No Separate Counsel

Percentage of complexes, 1998–2020



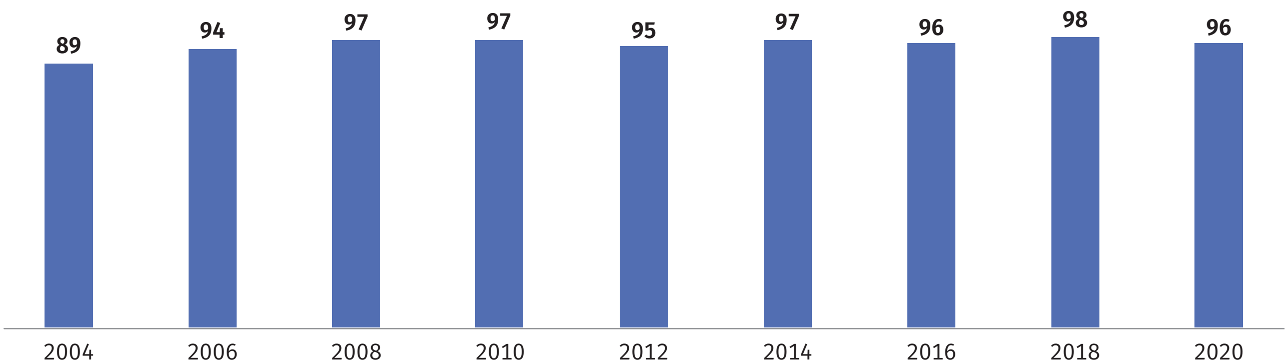
Audit Committee Financial Expert

SEC rules require funds to disclose whether they have at least one financial expert serving on the audit committee of the board and, if so, the name of the expert and whether the expert is independent of management. Funds that do not have an audit committee financial expert must disclose the reasons why.[11] The studies collect data on whether complexes have an audit committee financial expert and find that virtually all (96 percent) complexes have a financial expert serving on an audit committee, notwithstanding that they are not required to do so (Figure 27).

FIGURE 27

Complexes with Audit Committee Financial Expert

Percentage of complexes, 2004–2020



Conclusion

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

Notes

[1] ICI and IDC collect data on board practices from participating fund complexes through the *Directors Practices Study: Practices and Compensation*. The first such study, conducted in 1995, collected data covering the year ended December 31, 1994, and 4,048 funds were represented. Subsequent studies covered 1996 (5,191 funds), 1998 (6,452 funds), 2000 (7,740 funds), 2002 (8,073 funds), 2004 (7,549 funds), 2006 (7,764 funds), 2008 (7,690 funds), 2010 (7,756 funds), 2012 (8,235 funds), 2014 (8,841 funds), 2016 (9,119 funds), 2018 (8,940 funds), and 2020 (8,659). This overview will use the term *studies* to refer to all of the biennial studies collectively; results that are unique to a particular study will be identified by year.

[2] ICI and IDC, *Overview of Fund Governance Practices*, 1994–2018.

[3] Securities and Exchange Commission, Investment Company Act Release No. 24816 (January 2, 2001) (adopting rule amendments focused on board governance requirements of independent directors for funds relying on certain exemptive rules). Most funds rely on at least one of the exemptive rules. Accordingly, this overview discusses the governance requirements as generally applying to all funds.

[4] Securities and Exchange Commission, Investment Company Act Release No. 26520 (July 27, 2004) ("2004 SEC Rules").

[5] *Chamber of Commerce v. Securities and Exchange Commission*, 443 F.3d 890 (DC Cir. 2006). The SEC subsequently sought additional comment on the invalidated fund governance rules but then took no further action.

[6] SEC Staff Statement, "Division of Investment Management Staff Statement on Fund Board Meetings and Unforeseen or Emergency Circumstances Related to Coronavirus Disease 2019 (COVID-19)" (Mar. 4, 2020), available at **www.sec.gov/investment/staff-statement-im-covid-19**.

[7] The relief, dated March 13, 2020, along with subsequent extensions, allows fund boards to meet by telephone or by videoconference to vote on matters that otherwise would require in-person meetings, subject to certain conditions: (1) reliance is necessary or appropriate due to circumstances related to the current or potential effects of COVID-19; (2) the votes required to be cast at an in-person meeting are instead cast at a meeting in which directors may participate by any means of communication that allow all directors participating to hear each other simultaneously; and (3) the board of directors, including a majority of the disinterested directors, ratifies the actions taken pursuant to the exemption by vote cast at the next in-person meeting. Investment Company Act Release No. 33817 (Mar. 13, 2020), available at **www.sec.gov/rules/other/2020/ic-33817.pdf**.

[8] The 2004 study distinguished between independent chairs and lead independent directors because the 2004 SEC Rules mandated an independent chair (supra note 4). The independent chair mandate was later invalidated by a federal appeals court (supra note 5).

[9] Certain complexes with cluster boards have an independent chair and a lead independent director and are included in both measures in Figure 11. Accordingly, the percentage of complexes having either an independent chair or a lead independent director is less than the sum of these two measures.

[10] Under Section 2(a)(19) of the 1940 Act, the SEC also may issue an order finding a person who had a material or professional relationship with the principal executive officer of the fund, investment adviser, or principal underwriter; with any other fund having the same investment adviser, principal underwriter, or the principal executive officer of such fund; or with any controlling person of the investment adviser or principal underwriter, within the past two fiscal years, to be an interested person.

[11] Securities and Exchange Commission, Investment Company Act Release No. 25914 (January 27, 2003).

About Fund Independent Directors

Fund independent directors serve as fiduciaries on the boards of mutual funds, exchange-traded funds, and closed-end funds. They represent the interests of the more than 100 million shareholders who invest in funds for retirement, college savings, and other financial goals. In representing the interests of fund shareholders, independent directors are separate from the investment adviser that manages the fund's portfolio of investments.

About IDC and ICI

The Independent Directors Council (IDC) serves the US-registered fund independent director community. Through its mission focused on education, engagement, advocacy, and public understanding, IDC promotes excellence in fund governance for the benefit of funds and their shareholders.

IDC is part of the Investment Company Institute (ICI), the leading association representing regulated funds globally. IDC leverages the research, advocacy, operational, and other resources of ICI to amplify IDC's effectiveness in its mission to serve independent directors. IDC's activities are overseen by a Governing Council of independent directors of ICI member funds and are supported by dedicated IDC staff.

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