INDEPENDENT DIRECTORS COUNCIL™

The voice of mutual fund directors at the Investment Company Institute

Director Oversight of Multiple Funds

Independent Directors Council
Task Force Report
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DIRECTOR OVERSIGHT OF MULTIPLE FUNDS

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EXECUTIVE SUMMARY

- The unitary or cluster board structure, in which directors oversee all or many of the funds in a complex, is prevalent in the industry and is consistent with good governance.

- Neither Congress nor the Securities and Exchange Commission have found that imposing an arbitrary limit on the number of funds a director may oversee would be in the best interests of shareholders. Rather, the SEC has required that boards evaluate their performance in this regard as part of an annual self-assessment.

- Mutual funds within a fund family share the same investment adviser and other key service providers and, as a result, significant efficiencies are realized when a single or limited number of boards oversees all of the funds.

- Independent directors control who serves as an independent director and the amount of compensation for each director. Control of these processes by independent directors is a critical factor in assuring director independence.

- Oversight of significant assets enhances a board's knowledge and expertise and its ability to influence fund management and key service providers and, as a result, enhances the board's effectiveness in serving the interests of shareholders.

- The tasks of a fund director involve a common regulatory structure, common personnel and service providers and oversight mechanisms that are complex-wide. These tasks contrast significantly with the role of a corporate director that, in many cases, involves oversight of multiple product lines, several business units, numerous business plans and management teams, and diverse regulatory structures and compliance issues.

- Mutual fund boards have developed a number of techniques and strategies that address the challenges inherent in the oversight of multiple funds and that enable directors to meet their responsibilities to shareholders.

- Limiting the number of funds a director may oversee is not only inefficient, it would result in significant additional management, service provider and director costs to shareholders.

- Board annual assessments provide an opportunity for boards to periodically evaluate their ability to continue to provide appropriate oversight to the number of funds for which they are responsible. A board can take into account a number of relevant factors, including the types of funds involved, the support the board receives and the strategies the board uses to manage its workload.

I. Introduction

Today corporate governance and mutual fund governance in particular are topics receiving much attention. Fund governance is important in achieving shareholder goals because good governance by its nature puts the interests of shareholders first. The public discussion of governance issues has included an examination of the issue of director oversight of multiple funds within a fund complex. However, wisely in our view, neither the Congress nor the Securities and Exchange Commission ("SEC") has attempted to impose an arbitrary limit on the number of funds a director may oversee. The SEC has identified this as a matter that should be specifically included in the annual board self-assessment.[1]

The Independent Directors Council[2] formed a Task Force of independent directors to study fund oversight, and to examine the specific issue of director oversight of multiple funds.[3] This report, which reflects the directors' collective views of this issue, is intended to promote better public understanding of this aspect of fund governance and to assist fund boards as they undertake the self-assessment process.

This report will first outline the fund and board structures that are prevalent in the mutual fund industry today. It then will analyze the efficiencies and other advantages that these structures provide to fund directors in fulfilling their oversight responsibilities, and discuss the governance arrangements and strategies that mutual fund boards and their independent directors commonly rely upon to facilitate oversight of multiple funds. Finally, the implications of arbitrarily limiting the number of funds overseen by an individual director will be presented.[4]

II. Prevalent Fund and Board Structures

There are unique structural aspects of mutual funds that must be understood to assess whether any group of directors has undertaken oversight of "too many funds." The industry's structure differs substantially from that of public operating companies, making the implications of a director's oversight of multiple funds quite different from the implications of oversight of multiple operating companies.

What is commonly referred to as a *mutual fund* is an *investment company* – an entity that is organized under state law (as a corporation or business trust), that is registered with the SEC, and that is required to have a board of directors or trustees. An investment company may have one or more portfolios.[5] A mutual fund *family* or *complex* is comprised of a number of investment

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[1] *See* Investment Company Act Release No. 26520 (July 27, 2004) [Adopting Release] available at http://www.sec.gov/rules/final/ic-26520.pdf. The SEC noted in the release proposing the rule requiring self-assessments that the self-assessment should involve a careful evaluation of whether directors "have taken on the responsibility of overseeing too many funds." Investment Company Act Release No. 26323 (January 15, 2004) available at http://www.sec.gov/rules/final/ic-26323.pdf.

[2] The Independent Directors Council serves the mutual fund independent director community and provides a venue to advance the education, communication and policy positions of mutual fund independent directors.

[3] The Task Force members, who individually oversee as many as 300 funds and as few as 6 funds, are listed at Appendix A.

[4] This paper covers service on both open end and closed end fund boards, although the term "mutual fund" technically does not include closed end funds.

[5] A single investment company may have numerous portfolios that differ from each other principally with respect to their investment objectives and strategies, and their fees. This type of investment company, frequently called a *series fund,* may

companies and the portfolios they include. In most cases, different investment companies within the complex are overseen by one or only a few groups of directors. When a single board of directors oversees all of the investment companies (and associated portfolios), this is known in the industry as a *unitary* board structure. In a *cluster* board structure, a complex will have several separate boards overseeing different groups or clusters of investment companies. The cluster or grouping of investment companies under a given board may be deliberate -- dictated by investment or distribution considerations, for example. It also may be a result of the history of a fund complex – for example, the merger of fund families that were sponsored initially by different fund management firms and whose investment companies therefore had different boards prior to the merger. Surveys conducted over the years by the Investment Company Institute indicate that, while unitary boards are by far the most prevalent structure, cluster boards are not uncommon.[6]

There are sound practical and economic reasons that unitary or cluster board structures predominate in the industry. Most of the investment companies (and their portfolios) within the same family or complex are created by the same fund management firm and have a common investment adviser, principal underwriter and administrator. They commonly receive necessary services (including, for example, portfolio management, shareholder recordkeeping, custody of fund securities, distribution of fund shares, legal counsel, and auditing) from the same entities. Investment company complexes are organized around these common operating features and are designed to take advantage of the efficiencies inherent in single service providers, as described in more detail below. It is unnecessary (and undesirable in terms of cost and administrative burdens) to require each investment company to have a separate board performing similar if not identical functions.

The Task Force recognizes that some of the commentators suggesting a limit to the number of funds a director can oversee have sought to equate the task of the mutual fund director with that of a corporate director. They have suggested that recommended limits on board memberships for corporate board members might be appropriate for fund directors. In the view of the Task Force, this analysis is overly simplistic and is not instructive for those seeking to evaluate how fund directors are able to effectively manage their workload. An independent director of a major corporation typically oversees many separate business units in numerous diverse industries, involving different business plans, management teams, workforces and locations and regulatory and compliance concerns. These companies frequently engage in acquisitions and dispositions that require substantial attention from their boards. In addition, the tax and accounting issues facing these companies are numerous, complex, and specific to different business lines. Directors of these companies are expected to be familiar with all these matters.

The responsibilities of mutual fund directors, on the other hand, are more focused. Fund directors are charged with having a basic knowledge of the Investment Company Act of 1940 ("1940 Act") and those portions of the other securities laws that relate to mutual funds. These laws are

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include – and its board would oversee – a variety of different stock, bond, balanced or money market portfolios. Each of these portfolios is *not* a distinct corporate entity under state law (although each is regarded for certain federal securities laws purposes as an individual fund).

[6] As of year-end 2002, 77% of the fund complexes participating in an ICI study reported that they had a unitary or pooled board structure; 15% had a cluster board structure. Data compiled from the Investment Company Institute Directors' Practices Study (July 25, 2003).

applicable across all funds that the director serves and relate to parties and relationships that are often common across an entire fund complex. Mutual fund accounting is quite straightforward and is similar, if not identical, across all funds in the complex. Because the major public company and the mutual fund are not comparable, the Task Force concluded that it is not appropriate to draw conclusions about the ability of a mutual fund director to serve multiple funds by looking at whether it would be feasible for the same individuals to serve effectively on the boards of numerous operating companies.

An essential component of fund structure is how and by whom fund directors are selected and compensated. Some commentators have suggested that directors who oversee multiple funds become captive to management; however, this assertion ignores the fact that independent directors nominate and elect independent directors[7] and determine the amount and method of their compensation, compensation that is paid by the funds, not by the management company. The fact that management companies do not control who serves as an independent director on a fund board or how much fund directors are paid is a critical factor in assuring director independence.

III. Efficiencies of Board Oversight of Multiple Funds

The practice of having a board oversee multiple funds or portfolios that is prevalent within the mutual fund industry is not a historical accident. Rather, it is a logical approach to corporate governance, derived from the unique features of mutual funds.

There are several reasons for this. First, due to the detailed regulatory scheme established under the 1940 Act, which governs all mutual funds, the issues faced by fund directors generally apply to all of the funds that they oversee. Second, because all funds within the same complex generally are served by common personnel and utilize common service providers, the manner in which these issues are addressed tends not to vary much fund-by-fund. Third, the mechanisms that boards use to assist in their oversight of funds and fund service providers generally apply on a complex-wide basis. Fourth, the practice of having a single board oversee all of the funds within a complex – or within a cluster of funds in the complex – enhances the board's knowledge and expertise, as well as its authority and influence.

A. Common Regulatory Structure

In addition to the duties under state law of care and loyalty that are common to all directors, mutual fund directors are subject to a series of specific obligations imposed under the 1940 Act and under various SEC rules and interpretations. Most of the duties – and the standards by which fund directors discharge them – apply in the case of all funds.

For example, fund directors are required to, among other things: establish standards for the valuation of portfolio securities; review the liquidity of certain types of portfolio securities;

[7] Funds relying on certain popular exemptive rules currently are required to have a majority of the directors as independent directors. In January 2006, the percentage of the board that must be independent directors increases to 75%. With this distinct majority, they can elect independent directors of their choosing to the board. *See* Rule 0-1(a)(7) of the 1940 Act. Obviously, management directors are elected by the entire board. Board processes as to the selection of management directors vary.

oversee fund brokerage, soft dollar, and trade allocation procedures; review and approve codes of ethics; review and approve plans for allocating common expenses among funds in the same complex; review and approve fidelity bonds and joint liability insurance policies; monitor certain types of custody arrangements; review and approve anti-money laundering procedures; and approve procedures governing certain types of affiliated transactions. The standards that govern directors' determinations in these areas apply to all funds in the same complex.

In addition, all funds are subject to the same disclosure standards, and many specific disclosures are similar for funds in the same complex, which can facilitate director review of documents such as registration statements and shareholder reports. Fund accounting issues are similar across the entire complex and fund-specific issues such as pricing of portfolio securities are easily identified.

Certain director obligations require analysis on a more fund-specific basis. Perhaps the best examples of this are the board's annual review of the advisory contract and the board's evaluation of fund performance. Obviously, a board must evaluate each fund's fees and expenses and investment results. But, even in this case, many factors the directors must consider will be common to all of the funds within a complex, such as the nature and quality of shareholder services, the adviser's compliance record and systems relating to portfolio trading practices. In addition, in order to assess profitability and economies of scale, a fund board must understand the methodologies used by the adviser to allocate costs and profits among all funds in a complex.

Other issues can arise that involve a particular portfolio, or group of portfolios. For example, international equity and high yield bond funds may be more susceptible to market timing and may present more substantial issues of fair valuation. Still, boards benefit from being able to apply their expertise when a similar issue arises in the cases of other portfolios (*e.g.*, market timing and valuation issues for small-cap equity funds).

B. Common Personnel and Service Providers

Business operations for mutual funds within a complex tend to be quite similar, as all funds generally are served by the same executive management team and external service providers. Almost all funds are externally managed; the funds' investment adviser, which is responsible for portfolio management and often numerous other services, performs these services pursuant to a written contract with the funds. (The adviser is most often the sponsor that formed the funds in the first instance.) In the case of complexes of funds that are internally managed, the same personnel typically service all of the funds in the complex.

Similarly, funds within the same complex generally have a common principal underwriter, transfer agent and administrator (if the fund has a separate administrator). Funds within a single complex often have the same custodian as well, although it is not uncommon for there to be more than one custodian assigned to certain funds in a complex with particular safe keeping issues. Funds within a single complex also generally have common professional service providers, such as fund counsel and fund auditors. (Occasionally, a fund complex may use two or more audit firms, each of which audits different funds in the complex.) Other entities that provide services

to funds – such as insurance carriers and pricing services – also generally provide these services to all of the funds within a complex.

Because all portfolios within a fund family tend to have common management and external service providers, policies and practices within a fund family, as well as contractual arrangements, are fairly uniform. Examples of these include shareholder services (*e.g*., exchange privileges, on-line services); compliance monitoring procedures (including funds' codes of ethics); proxy voting policies and procedures; anti-money laundering procedures; privacy policies and procedures; brokerage allocation and soft dollar policies; fair valuation policies and procedures; and arrangements with dealers and other intermediaries. The Task Force believes that it is generally far more efficient to have a single board review these common policies and procedures, and oversee common arrangements, than to have multiple boards do so. In addition, in cases where a board concludes that changes in fund policies, procedures, or arrangements are warranted, it will invariably be far easier to implement such changes on a complex-wide basis than in a piecemeal fashion (which could easily occur if different boards were to come to different conclusions).

C. Complex-Wide Oversight Mechanisms

The mechanisms that directors employ to facilitate their oversight of funds tend to be uniform across a fund complex. Perhaps the best example is implementing the SEC's new rule[8] requiring that each fund have a chief compliance officer ("CCO"). All funds within a complex generally have a common CCO. Under Rule 38a-1, the CCO is required to report directly to the fund board and meet at least annually with the independent directors in executive session. As the SEC stated in the release adopting Rule 38a-1, "The rule provides the board with a powerful tool to exercise its oversight responsibilities over fund compliance matters . . . Under the new rule, the chief compliance officer will be responsible for keeping the board apprised of significant compliance events at the fund or its service providers and for advising the board of needed changes in the fund's compliance program."[9] The Commission noted as well that the appointment of a chief compliance officer was intended to replace practices that "balkanize responsibility for fund compliance."[10] Thus, the compliance rule clearly envisions a unified compliance program under the overall supervision of a single or limited group of fund directors.

Directors also employ other service providers, such as contract analysis consultants. These entities typically provide services with respect to all funds within a complex. Finally, directors rely heavily on fund auditors. The relationship between fund auditors and fund directors is especially important; the Task Force believes that it is critical that directors maintain a strong and ongoing relationship with senior members of the fund audit team. Doing so promotes better monitoring of the audit function and of auditor independence.[11] This is much easier if the auditors report to a single board, or a few cluster boards, than to many different fund boards.

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[8] Rule 38a-1 under the 1940 Act.

[9] *Compliance Programs of Investment Companies and Investment Advisers,* Investment Company Act Rel. No. IC-26299 (December 17, 2003).

[10] *Id*. at 12.

[11] There also are efficiencies in terms of cost and time. Auditors are required to make nearly identical presentations to each board. Because the scope of the audit doesn't change, considerable time is saved by making a single presentation to a single board. Furthermore, audit system improvements can be easily implemented. Audit committee review of annual reports, which

D. Enhanced Board Influence

The fourth, and perhaps most important, reason why multiple fund oversight is an effective structure is that it enhances a board's ability to oversee and influence fund management and key service providers and, as a result, enhances the board's effectiveness in serving the interests of fund shareholders. The members of the Task Force strongly believe that a board's influence with management is greatest when the board oversees a significant portion of the firm's fund assets under management. Dividing fund boards into smaller groups would diffuse influence by spreading it among a number of boards, no one of which may have the authority to influence the management of a major asset pool or a large number of funds. Single fund boards lose one of the board's key bargaining issues -- economies of scale. The Task Force also believes that a unitary board has a greater ability to negotiate with management over matters such as fund fees and expenses; the level of resources devoted to technology, compliance and audit functions; and contingency planning. Management is also more readily able to respond to a request for a change in policy or for additional information when it comes from a single board or limited number of boards rather than many boards, thus minimizing the delay or inaction caused by the need to coordinate multiple and possibly inconsistent requests.

A board that oversees multiple funds also is more likely to have extensive contact with senior management, and to develop an ongoing and productive dialogue with them. If management must attend to a large number of fund boards, it most likely would delegate the responsibility of dealing with directors to a team of less senior and perhaps more specialized staff members. This team would sit between the board and management, impairing significantly the ability of board members to influence senior management. Direct contact makes it easier for the board to gain a thorough understanding of the integrity and overall attitude of the management team. As the recent scandals demonstrate, this type of oversight may ultimately prove to be the most important to the general welfare of fund shareholders.

For all of the foregoing reasons, the Task Force believes that the practice of director oversight of multiple funds within a single fund family is optimal and serves fund shareholders well.

IV. Strategies to Facilitate Oversight of Multiple Funds

Notwithstanding the benefits of overseeing a large number of funds, the task is demanding and time-consuming. It necessarily generates more work for the directors on a board and requires a greater time commitment from each.[12] As the number of funds increases, boards have developed a number of strategies and techniques that address the challenges inherent in the oversight of multiple funds and that enable directors to meet their responsibilities to shareholders. Boards should consider whether these strategies might contribute to the effectiveness of their operations.

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currently can be managed in groups of similar funds whose audit issues such as pricing of portfolio securities are similar, are streamlined.

[12] Individual directors who are being recruited by fund groups should understand the time commitment involved before they join a board. This commitment should extend beyond attending board meetings, to cover extensive time preparing for board meetings, the initial education effort to familiarize the director with the activities of the fund complex and a commitment to ongoing education through attendance at industry conferences and seminars. In some cases, it may be necessary for the director to agree to limit other outside commitments, such as service on other fund, corporate or non-profit boards.

A. Organization and Composition of a Board

A board should organize itself in a way to facilitate oversight of multiple funds. This may include consideration of a unitary or cluster board structure and the use of committees discussed in this report. The board should regularly evaluate its structure, as well as its composition to ensure that it is adequate to undertake the responsibilities assigned to it. The size of the board and the competence and experience of the directors also are relevant areas of inquiry. It may be necessary for the board to add members so that it is of sufficient size and includes directors with requisite expertise (*e.g*., financial expert) to perform its oversight role most effectively.

B. Frequency of Meetings

The number of funds a board oversees may dictate a need to increase the number of meetings the board holds each year. This may be accomplished by increasing the number of times the board meets and/or by extending the meetings to more days. In either case, the board should ensure that it has reserved adequate time for a thorough review of complex-wide, as well as fund specific matters. This determination is directly related to the structure of the meetings and the development of other good governance practices.

C. Good Governance Practices

Directors should examine the structure of board meetings to ensure that the meetings are productive and efficient and that materials are easily understood and accessed. In addition, each board should develop, with the assistance of counsel and the CCO, an annual calendar of required actions so that it can assess the full scope of these requirements and plan accordingly.

Faced with mounting obligations, boards have developed a number of strategies to manage the workload. These include: (1) chair development of board agendas and coordination of materials well in advance of meetings to assure that the independent directors have necessary data in a useful format and that they meet with the personnel they wish and need to see;[13] (2) determining, organizing and managing the nature and length of all board presentations;[14] (3) staggering contract renewals so that a discrete number of contracts are reviewed at each meeting;[15] and (4) grouping contract renewals by fund type to enable board members to more easily consider renewal data such as expenses and fees charged by comparable funds.

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[13] *See* Adopting Release, *supra* note 1, at 8.

[14] For example, some boards have taken the step of limiting PowerPoint presentations.

[15] While contract renewal is an annual requirement, for most boards it is in fact an ongoing process. As a practical matter, management performance and shareholder services are reviewed at every board meeting, not just at contract renewal times. Directors and management personnel will be aware of those funds with performance issues or those funds with issues related to fees and/or expenses or service problems and these issues can be subject to an ongoing dialogue between management and the fund board. When the calendar date for contract renewal arrives, valuable meeting time can be devoted to deliberations and making the findings necessary to renew the contract. This is the case whether the contract review for all funds is spread over several meetings or whether renewal presentations are staggered with the actual review reserved for a single meeting.

D. Use of Committees

Boards that oversee many funds often make extensive use of committees to manage the workload. Committees can be tasked with performing some of the background or detail-oriented work, thus preserving the board time for reports and discussion.[16] It may be logical to divide responsibilities among committees for particular fund types or distribution channels. Use of committees may be particularly effective in connection with the processes for contract renewal and portfolio performance review. Some fund complexes divide the in-depth review of contracts among various board committees, for example, one for equity funds, one for municipal bond funds, one for taxable, fixed income funds, *etc*. Others delegate the more detailed work to a contract committee.[17]

E. Professional Assistance for the Board

Each board should consider the professional assistance that may be required for the board to oversee multiple funds effectively. This may consist of assistance from fund management, independent counsel, outside consultants and service providers or staff hired by the board. Many boards are able to call upon personnel of the management company on an ongoing or as-needed basis to assist the board. Areas where this may be particularly helpful include addressing individual fund performance and conducting risk assessments of investing in new types of instruments.

Boards should have access to the assistance of independent counsel. Independent counsel's expertise is critical to ensuring that all regulatory requirements are met. In addition, his or her familiarity with practices of a number of boards may result in new ideas for workload management. Boards also may elect to take advantage of other professionals to assist in various aspects of their work. Many boards employ third party consultants to assist with contract renewal. Boards use these third party consultants to assemble and present data, and work with these consultants to assure that the presentation format and content are focused and easy to use.[18] For example, data on fees and expenses of comparable funds can be presented in bar graph, pie chart or scatter graph format, which permits a director to see instantly where any fund stands in relationship to comparable funds. Much of the data used draws upon databases with which directors become very familiar over time.

F. Transferring Information Outside of Meetings

Technological advances belie the arguments of some who contend that directors overseeing multiple funds are not capable of reviewing information necessary to approve contracts. Many

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[16] The number and nature of committees vary among boards depending upon such factors as the type and size of funds overseen by the board.

[17] To ensure that delegation to a committee does not impair the ability of a director to raise concerns, boards often employ processes that permit any director to call for a full board review of the details of any particular contract.

[18] Directors are proactive and aggressive in developing systems and procedures to manage data flow and maximize director efficiency. Directors benefit by participating in the task of formatting the data for efficient consumption because designing the format requires an in-depth understanding of the raw data and its sources. Data formatting and analysis are under constant review and changes or enhancements to contract data analysis are frequent.

fund complexes have sophisticated methods for transferring information.[19] Under these systems, directors may receive data at any time during the year and substantially in advance of each meeting. By the time a director attends a committee or board meeting at which contract approval is to be considered, a massive information transfer already has occurred and the director has done a significant amount of homework. These innovations have made it even easier for board members to ensure that board meetings are productive.

In fact, some director tasks that are unique to each fund occur outside the boardroom. So, even if a director oversees a large number of funds, the detail work is performed in advance of meetings and need not be discussed at the actual meeting. For example, the review of registration statements, proxy statements and of semi-annual and annual reports may be board homework, accomplished whenever the fund director chooses to devote attention to these matters.

V. Impact of Limiting the Number of Funds Overseen by Fund Directors

The number of funds within a complex that a director oversees is not a determinative factor in analyzing his or her ability to effectively serve shareholders. While there may be circumstances where a limit on the number of funds would be appropriate, the Task Force believes that this would, in the vast majority of cases, not be in the best interests of shareholders, as those shareholders would lose the benefits of oversight of multiple funds. As noted above, limiting oversight to some arbitrarily established number of funds would not, for example, improve the contract renewal process. Instead, it could reduce the ease of access to key personnel and service providers. In fact, many independent directors believe that they better serve each fund in their group because of the experience they have gained from oversight of a wide variety of funds -- they are familiar with complex-wide data and their knowledge of the data content across the entire complex facilitates critical analysis. Similarly, limiting the number of funds a director may serve would not improve the ability of boards to oversee fund compliance and risk management or to deal with pricing issues because these issues are, for the most part, not sensitive to the number of funds the director is overseeing.

A. Further Inefficiencies and Increased Costs

This report has outlined some of the large scale efficiencies that are realized through oversight of multiple funds. Limiting the number of funds overseen by directors also could create a number of inefficiencies on a smaller scale, the impact of which could be significant additional cost. By way of illustration, if there were 10 separate boards overseeing 14 separate funds each, as opposed to one board overseeing 140 funds, and management representatives and service providers were required to meet with each separate board, costs would increase exponentially and the time commitment of all persons who interact with the board regularly would increase several-fold. This would result in considerable duplication of board expense and efforts by all service providers. It also would deploy resources away from other matters important to shareholders interests.

[19] Some boards are now using web-based systems through which fund directors can access board materials from anywhere in the world. Emails are sent advising directors of the availability of new data. Other boards send directors information on CD-ROM.

There are several specific areas where the inefficiencies presented by such a proposed structure are readily apparent. First, additional staffing would certainly be required to attend to the additional boards on an ongoing basis.[20] Second, the time and personnel needed to prepare for meetings would increase. Additional time allowances would be needed to collect and organize the materials for each meeting, review the agenda and materials in advance with each independent chair,[21] and to consult with the CCO, general counsel, board counsel and independent auditors.

Meeting time also would increase. There would be duplication of service provider presentations, approvals and documentation, notwithstanding the fact that these would be substantially identical for each fund.[22] Individual boards also could develop policies and procedures that differ from one another without substantive effect and that require different reports from the management company and external service providers.

Communication among boards and between multiple boards and the management company would require time and coordination, significantly reducing the prospect of a speedy resolution of issues. It also significantly reduces prospects for harmonizing matters within a fund family, including policy positions, regulatory procedures, board compensation and committee structure. Consider, for example, if a consensus has to be reached regarding a complex-wide issue (*e.g.*, the performance and pay of the CCO). Collecting information from all of the boards, reconciling differences and reaching a final conclusion would require substantial time and energy. This process would detract from the energy and resources that directors should be devoting to more substantive issues and would be contrary to the best interests of shareholders.

Expenses would unquestionably increase as a result of these inefficiencies. This increased cost would either be passed on to fund shareholders, result in increased management resistance to fee reductions, or a combination of both. The attention of the management company also would be deflected from managing the funds toward managing relationships with multiple boards. In addition, travel and attendance fees of independent directors, which are a fund expense, would increase.

B. Other Possible Negative Consequences

Beyond the specific adverse consequences described above, the Task Force believes that there may be additional, less obvious, negative consequences to limiting the number of funds a director may oversee. It is quite conceivable that, faced with significantly increased costs and time commitments in dealing with multiple boards, management companies may be less willing to introduce or maintain niche funds targeted to a smaller investor audience. This would not only deny investors in those target audiences the opportunity to invest in new types of funds, it also

[20] Many boards establish a management company contact person to work directly with their chairs. Managing information flow to one board is virtually a full time job. Increasing the number of boards could likely require additional personnel, with the increased risk of inconsistent communication and information.

[21] The inefficiencies would be exacerbated because independent chairs would need to spend time coordinating presentations for their respective boards.

[22] Inefficiencies also would arise in areas such as policies or practices relating to pricing and fair valuation, securities lending, anti-money laundering, privacy, accountant independence, broker-dealer marketing, portfolio compliance monitoring, counsel independence, compliance monitoring systems, proxy voting, insurance, human resource concerns (adequacy and competence of service provider staff), succession planning and disaster contingency planning.

might impede industry innovation. Many funds popular today, including money market funds, managed municipal bond funds, and sector funds, began as niche products.

Serving on a board that oversees multiple funds is a time-consuming and challenging job, and requires, as funds under management increase, a very significant commitment from board members. A fund group that employs a structure comprised of many boards may find it more difficult to attract directors of the highest caliber.

VI. Conclusion

The members of the Task Force are of the unanimous view that a unitary or cluster board structure is the most efficient structure for a mutual fund family, and that any arbitrary limit on the number of funds within a complex that could be overseen by a director would be counter-productive and harmful to fund shareholders. As a general matter, the Task Force believes that the burdens on fund directors do not increase significantly as the number of funds they oversee increases. In fact, significant benefits arise when a director oversees all, or a significant portion of, funds in a single family, both in terms of efficiencies and in terms of effectiveness of the directors in protecting the interests of fund shareholders. At the same time, the Task Force recognizes that directors face additional challenges as the number of funds that a board oversees increases. A director's capacity to address these challenges successfully and undertake oversight of multiple funds depends on many factors including the types of funds involved, the support the board receives and the strategies the board uses to manage its workload. The Task Force believes that all boards must assess, as part of the annual assessment process, their own unique circumstances and the board structure and the optimal number of funds monitored by each director that is most effective and best serves their shareholders.

APPENDIX A

Task Force Members

James H. Bodurtha	Merrill Lynch Funds (38 Funds with 55 portfolios)
Peter Brown	TT International Funds and Capital Growth Management Group (6 Funds)
Dawn-Marie Driscoll	Scudder Funds (48 Funds)
William H. Foulk, Jr.	AllianceBernstein Funds (47 Funds with 121 portfolios)
Sam Freedman	OppenheimerFunds (38 Funds)
Armon Kamesar	Smith Barney Funds (28 Funds)
Robert E. LaBlanc	Prudential Funds (91 Funds)
Marvin L. Mann	Fidelity Funds (300 Funds)
Robert D. Neary	Armada Funds (32 Funds)
Ruth H. Quigley	AIM Funds (113 Funds)
Patricia L. Sawyer	Diversified Investment Advisors (64 Funds)
Robert Straniere	Reich & Tang Funds (9 Funds)
Roger B. Vincent	ING Funds (142 Funds)