On Board, at a Mutual Fund

Little-known, directors of mutual funds can pull in six figures—for what?

By
James Sterngold
Wall Street Journal
Sept. 3, 2014 11:13 a.m. ET

IT MAY BE the most lucrative job you never heard of, and the companies involved may be delighted to keep it that way.

Investors have poured more than $10 trillion into mutual funds through the end of the second quarter, according to Morningstar Inc., but despite that avalanche of precious savings few have a clue that every single fund is actually a separate company or trust and that each has its own board of directors or trustees with a single job: insuring that investors get fair returns at a fair price from the adviser. Most think they are customers of that adviser, often giants like Fidelity Investments, Vanguard Group or T. Rowe Price, but the manager is actually just a hired hand. The board negotiates the fee with them every year, at arm's length, and holds them to account if they fail to deliver a decent return. Or else.

Nice theory. The reality, some experts say, is that the boards are not truly independent, are not really elected by investors and do not take tough stands with the portfolio managers they supposedly police. Nevertheless, in return for approving what are usually lucrative fees to fund managers, the directors are well paid—in some instances, very well paid.

"Corporate boards fire CEOs all the time, or they change the company's direction, but with mutual funds it almost never happens," says John Morley, a Yale Law School professor who has written extensively on funds. And while mutual-fund directors are supposed to be independent, in reality they are often chosen by the fund manager they oversee, Mr. Morley says. Investors rarely if ever vote them in.

How great a deal is it? The outside directors of the boards of a cluster of Pacific Investment Management Co., or Pimco, mutual funds, for instance, were paid between $306,000 and $417,000 in the fiscal year ended March 31, 2013. The outside directors of a large group of BlackRock Inc.'s funds were paid $315,000 to $388,750, and at Fidelity outside directors of some equity funds were paid $400,000 to $554,250, according to company filings.

And those directors often sit on the boards of more than 100 funds within the mutual-fund families, presumably giving each and every one equally intensive scrutiny. By comparison, the outside directors of the giant Exxon Mobil Corp. were paid roughly $340,000 each last year, and about $300,000 at International Business Machines Corp., according to company filings. "It's a very sweet deal," says Niels Holch, the executive director of the Coalition of Mutual Fund Investors, an advocate for small investors.

The fund companies declined to comment. But Amy Lancellotta, the managing director of the Independent Directors Council, a trade group, says concerns about fund directors are misplaced and that boards actually do a good job of standing up for investors, especially given the boards' broad responsibilities. Boards police the advisers for conflicts of interest, insure fees are reasonable and, rather than replacing advisers when performance sags, something most investors would not want, they can pressure the advisers to replace weak portfolio managers, she says.

Lancellotta also says that having directors sit on dozens of fund boards is actually a good thing because the directors can develop much deeper expertise on the critical issues such as compliance, fund distribution and preventing conflicts. "It's more effective," she says. Laura Lutton, a research director at Morningstar Inc. who assesses boards, says that the mutual-fund directors usually are retired senior corporate executives, so they have plenty of time for the job and the gravitas to confront fund managers when there are weaknesses.

The boards generally do a pretty good job, she says, but a problem is the lack of transparency. Mutual-fund boards disclose much less than a regular corporate board, she says.

"Even for us, it's definitely hard to tell how well they're doing," she says.
The one document that discloses the most about mutual-fund boards--including director compensation, how manager fees are determined and how many different fund boards the directors sit on—is one of the most obscure in finance. It is called, rather innocuously, the Statement of Additional Information, or SAI. "We read them, but we could be the only ones," Ms. Lutton says.

Write to James Sterngold at james.sterngold@wsj.com