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SEC's Chair White: Fund Directors Should Provide Oversight, Not Management; Consider "Emerging Problems of Tomorrow"

By Jay Baris

In a [speech](#) to the Mutual Fund Directors Forum (MFDF) on March 29, 2016, SEC Chair Mary Jo White acknowledged that regulators should not completely overload fund directors with additional responsibilities or confuse strong oversight with micromanagement of a fund.

The SEC must "be sensitive to where a director's oversight responsibility could cross the line into day-to-day-management," she said. Drawing an appropriate line is a challenge, she added, "one that the SEC is grappling with," as it considers proposed rules governing liquidity risk management and derivatives, among others, that are "designed to address the increasingly complex portfolios and operations of mutual funds and ETFs."

Evolving role – anticipating potential future risks. As mutual funds have grown in size, complexity and importance, Chair White said, investment strategies have evolved as funds increasingly invest in less liquid securities and use more derivatives. These developments were followed by new risks and challenges. As a result, the responsibilities of fund directors have also evolved.

Just as the SEC is recalibrating its regulatory program, Chair White said, fund directors also must adjust to growing responsibilities to ensure that funds are "fully addressing current and potential future risks." To be actively engaged and anticipate "the emerging problems of tomorrow," fund directors should:

- Ask tough questions of management to ensure that funds are prepared to handle new risks;
- Ensure that service providers have robust plans and procedures;
- Determine whether managers have identified potential harms and whether they are ready to handle them;
- Go beyond generalities and ask specific questions;
- Understand whether any links may exist between liquidity and valuation with respect to the funds they oversee;
- Ask whether management has considered back-up systems and redundancies of critical services providers; and
- Make sure that funds employ "robust, state-of-the-art prevention, detection and response plans" to address cybersecurity risk.

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Oversight, not day-to-day management. While reminding fund directors of their ever-expanding responsibilities, Chair White acknowledged that the SEC should not completely overload directors with additional responsibilities or confuse strong oversight with the management of the fund: “The role of the board is to provide independent oversight of these and other critical functions, and to approve compliance policies and procedures, not to perform them.”

The SEC, she said, should be sensitive to where a director’s oversight responsibility could cross the line into day-to-day management. However, drawing this line is a challenge, especially as the SEC grapples with its regulatory initiatives concerning liquidity risk management, derivatives and compliance in general.

To sue or not to sue, that is the question. Chair White said that directors who exercise their responsibilities effectively, perform their oversight role with diligence and skill, and operate in good faith, should not fear that the SEC will second guess them. But, she succinctly stated that “[w]hen directors fail to perform their duties, they should expect action to punish and deter such conduct.” She defended recent SEC enforcement actions against independent directors as examples of when directors failed to fulfill their responsibilities. She disagrees with the notion that the SEC acted too aggressively in these cases.

OUR TAKE

Chair White clearly intended to address suggestions that the new proposed rules’ requirements would impose on fund directors may tiptoe away from traditional oversight and inch closer to micromanagement.

She also sought to dispel the notion that fund directors are now walking enforcement targets. While her remarks may bring some comfort, they do nothing to change the reality that the role of fund directors is evolving as directors face increasingly complex portfolios and operations. The growing complexity undoubtedly will require directors to shift their focus.

Chair White’s bottom line: as long as you are fully informed, act in good faith with diligence and skill, the SEC will not sue you. On the other hand, if you fail to perform your duties, it will bring enforcement actions. Of course, the devil is in the details, and directors still face dual challenges: where to draw the line between oversight and micromanagement and how much diligence and skill is needed to avoid regulatory second guessing. These are still open issues.

Contact:

Jay Baris

(212) 468-8053

jbaris@mofo.com

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