MUTUAL FUND DIRECTORS FORUM
The FORUM *for* FUND INDEPENDENT DIRECTORS

Report of the
Mutual Fund Directors Forum

Practical Guidance for Fund Directors on Board Self-Assessments

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Executive Summary

The regulatory framework around mutual fund board self-assessments has not changed since it was adopted in 2006, although the duties and responsibilities of mutual fund directors have expanded and evolved to a significant degree. Fund board workloads have increased due to a range of market and industry developments that include fund regulation; heightened risks from technology and market events; evolving product distribution channels and shifting investor demand; and, most recently, a global health crisis. Boards that employ a robust evaluation process can be well-positioned to effectively meet current and future industry challenges.

Boards have wide latitude to make their self-assessments dynamic and to choose methods best suited to their particular board. This paper outlines a number of options for fund boards to consider.

The evaluation process can be most beneficial when all board members are involved and each director's contribution is valued. The board may wish to ensure that the process is transparent with well-defined objectives and outcomes that are monitored throughout the year. Governance specialists have advocated for the self-assessment process to be thoughtful, transparent, and ongoing throughout the year with attention paid to achieving realistic outcomes. Although a board may benefit from using the same evaluation process for several years, self-assessment processes can evolve over time to meet changing industry practices and board characteristics. Boards may wish to refresh their approach periodically and utilize evaluation strategies that envision continuous improvement for individual directors and the entire board.

The self-assessment process may also anticipate the issues boards will face and future skillsets that may be desired on the board. Emerging topics on the radar of regulators and other industry participants include crisis preparedness; cybersecurity; ESG; and diversity, equity, and inclusion. Boards may wish to encourage education in these areas in order to engage with the adviser and fund service providers on their responses to these wider market trends and to be prepared to oversee potential related risks. Boards that are attuned to and educated on these emerging issues may prove more agile and adaptable to change.

This paper also revisits the primary methods through which boards conduct their assessments. Many boards continue to prefer the interview or questionnaire methods. A few boards utilize peer reviews and individual assessments. Boards are responsible for conducting their own evaluations; however, many boards use third parties, commonly independent legal counsel, to guide the process. Boards have achieved the positive outcomes discussed in this paper as a result of making changes to and expecting more from their evaluation process.

I. Introduction

Annual self-assessments provide directors with an important opportunity to review whether they are meeting their fiduciary responsibilities and acting in the best interests of their funds and shareholders. In January 2006, the Securities and Exchange Commission ("SEC") required virtually all fund boards to conduct annual self-assessments, though some boards had conducted in-depth performance reviews long before then.[1] The board self-assessment has been the primary process through which directors evaluate the board's performance of its oversight role as prescribed by the SEC. Evaluations benefit boards by identifying and recognizing the strengths and possible deficiencies of the board with the goal of increasing board effectiveness to better serve the interests of the fund and shareholders.

In the period since the SEC's rule, mutual fund governance has evolved along with the duties and responsibilities of mutual fund directors. Major fund regulations, global health crises, increased risk and opportunities from technology and market events, as well evolving distribution channels and shifting investor demand, are among the challenges facing fund complexes and by extension fund boards. In addition, evolving issues such as cybersecurity, workplace culture and environmental, social and governance issues (ESG), are increasingly a part of regular boardroom discussions. The substance of fund board self-assessments has also begun to reflect the best practices of corporate governance aimed at encouraging more candor and spurring boards to act on the results of their evaluations in order to improve the board's effectiveness. This report aims to provide guidance to mutual fund directors after over a decade of experience with the operation of the SEC rule and the evolution of industry and corporate governance practices in the self-assessment process.[2]

Improving the Self-Assessment

Fund boards have come to regard the self-assessment process as an ongoing endeavor and have incorporated director evaluation elements into their annual calendar of meetings. Since board responsibilities have steadily increased as a result of regulation and industry changes, the self-assessment process has become, for many boards, a dynamic activity, with boards attempting to allot adequate attention to the issues that detract from or add to their effectiveness in the oversight of funds. The process is far from a once-a-year activity, and directors may wish to think about the evaluation process as akin to a movie and less a snapshot.

> **Outcome-Oriented Assessments**
>
> Define what is an effective, high-performing board and set measurable outcomes from the evaluation process. According to PwC's 2020 Corporate Survey, in 2014, 50% of directors said their board made changes as a result of their assessment process. In 2020, that figure was 72%.

Fund directors, many of whom also serve on public company boards, have seen the influence of corporate governance practices,[3] where experts have developed years of data and research to improve boards' effectiveness. While a corporate board is different from a mutual fund board, the data and research[4] from public company boards can be instructive for fund boardroom dynamics. Consultants' work on biases that inhibit candor and actions to be implemented after the assessment process, for instance, can be instructive to fund boards. Evaluations that adopt a holistic, systematic approach[5] to the smooth functioning of the board and the contributions of each board member in performing his or her obligations can be instrumental in how fund oversight and board statutory and fiduciary responsibilities are achieved. With effective leadership from the board chair and the governance committee, directors can fully commit to the evaluation process and generate measurable results over time.

General Practices

Although there is a range of possibilities for how a board conducts its self-assessment, there are several generally accepted base-line elements:

- Ensure that every director is involved and their input valued;
- Define clear goals and outcomes for the process;
- Provide all directors with adequate opportunity to discuss the findings that are made during the process; and
- Plan follow-up action based on the outcomes of the process.

Directors should not approach their board's self-assessment as just another "check the box" exercise, but instead should appreciate the opportunity to ask difficult, thought provoking questions. A robust self-assessment process that values candor, eschews groupthink, and prioritizes value creation and improved board performance will continually challenge directors to take a hard look at their board practices and to avoid validating existing practices without regard to whether those practices remain in the best interest of the funds and their shareholders.

PwC Perspectives on Barriers to Openness in the Boardroom[6]	
Authority bias: Overvaluing the opinion of one director with a particular set of skills or experience, or a director in a leadership role.	*Groupthink*: Being overly concerned with coming to a consensus.
Confirmation bias: Overvaluing evidence that confirms one's view, while undervaluing evidence that disproves it.	*Status quo bias*: Being reluctant to change the way things are.

II. Regulatory Requirements

The SEC[7] generally requires that funds relying on commonly used exemptive rules evaluate the performance of the board and its committees at least once annually.[8] The board self-assessment requirement and other reforms were intended to strengthen the independence of the board and to ensure that directors protect shareholders' interests.[9] The requirement gives directors the opportunity to step back from their regular board duties and examine what, if any, changes can be made to improve their governance process.[10]

The SEC felt that by reviewing their own operations, boards would gain a better understanding of their role, improve communication among directors, foster greater cohesiveness of the board as a whole, and help directors identify any areas that may need improvement.[11, 12] Due to the range of board processes, the SEC provided little guidance regarding what must be covered during the annual assessment, affording fund boards latitude to develop a self-assessment process most appropriate for a fund's particular circumstances. The SEC requires that annual self-assessments:

- Consider the effectiveness of the board's committee structure.[13]
- Include the substance of the board's discussion of the results in the board minutes.[14]
- Consider the number of funds served by each director to determine whether they have taken responsibility for too many funds.[15, 16]

Committee Structure: In evaluating the board's committees, directors should, at a minimum, consider the structure of committees, how each committee functions and be alert for possible deficiencies, such as slow reporting or poor communication with the full board. In particular, directors might evaluate whether their committee structure is appropriate in light of new regulation, such as the valuation, derivatives, and liquidity risk management rules. Changes in the adviser's business, such as a recent merger or new investment strategies, may also inform the board's committee structure evaluations. Committee assignments and leadership may also be refreshed and members rotated to vary directors' experience and relationships with other board members. Boards also may assess whether their current structure – committee of the whole, for example – should be reconsidered. Governance experts suggest other ways to evaluate a committee's overall effectiveness:[17] Inquiries can address whether key responsibilities noted in the charter were carried out; whether committee size and composition are adequate; and whether the board needs new or fewer committees.

Number of Funds Overseen: Directors should often assess the number of funds assigned to each director to determine whether each fund is receiving an appropriate level of oversight. This requirement can be particularly important when board members serve on multiple boards; in the aftermath of a merger that increases the board's workload; and when new regulation requires increased board reporting and oversight, to name a few scenarios.

The SEC's requirements on board self-assessments indicate the critical importance of board performance and effectiveness, and boards can expect the SEC staff to make inquiries about a board's self-assessment process during a regulatory examination.

III. Board Accountability

While the requirements from the SEC have not changed since the rule was adopted in 2006, boards will find it helpful to periodically review the process they use for their self-assessments. Although a board may benefit from using the same process for several years to establish continuity and allow for comparisons to be made from year to year, self-assessments should evolve over time to meet changing industry practices and board characteristics. Even the most highly functioning boards can improve their operations. Indeed, some respondents in a 2020 survey of mutual fund directors felt that their board self-assessment could be improved.[18] If the annual self-assessment yields only consistently high praise for a board's current governance methods with no suggestions for improvement, it may be time for an in-depth review of the process to make sure the board is fulfilling its duty to shareholders.

Not all funds are equal. They differ dramatically in terms of investment strategy, size, distribution channels, and procedures. Fund boards are no different – there are wide variations in terms of size, experience, working style, governance structure, and many other factors. Because of these differences, it is important that boards consider their unique circumstances before determining how best to pursue their self-assessment process.

Some boards have explored ways to prioritize and encourage feedback and director introspection on their performance throughout the year, although board evaluations are performed annually. Certain topics such as committee structure are more appropriate for an annual discussion whereas others such as such as meeting structure and timing or if board materials are adequate may be addressed more often. Some boards schedule annual retreats to commit to the assessment process, others allot time during executive sessions to discuss performance issues, or the board chair may speak to individual directors throughout the year to follow up on individual assessments. Independent counsel may also take a role in following up on the assessments during the year.

ASSESSING THE ASSESSMENT

+ Does the board as a whole and each director have a common definition of the term "effectiveness" as applied to the board as a whole, its committees and each director individually?

+ Did the most recent board self-assessment result in identifying action items to optimize board effectiveness?

+ Has the board formulated clear goals and objectives and standards for itself, its committees and each director that can be measured during the evaluation process?

+ Has the board defined what constitutes a successful outcome from the self-assessment process?

+ What do board members expect after they have completed their evaluations? Is there a timeline for meeting expectations?

See "Rethinking the Evaluation," by Holly Gregory, Partner, Sidley Austin. The Governance Counselor, March 15, 2015.

Many corporate governance experts advocate for the evaluation conversation to continue throughout the year, observing that board performance is enhanced when feedback is delivered more promptly — either in real time or over a short-term period.[19]

Boards can derive real value by redefining the self-assessment process as one that is ongoing.[20] Some experts also recommend that boards approach their assessments with a forward-looking lens, considering the challenges that a board will face in the future and the skills, capabilities and capacity needed to face those issues.[21] Practical steps boards can take to potentially improve board accountability in self-assessments include:

- More frequent opportunities to discuss board effectiveness as part of meeting agendas
- A process for providing director feedback or coaching throughout the year
- Reframing questions or diving deeper into particular areas where improvement is needed
- Implementing a mentoring program for newer directors with more seasoned directors.

The following data based on a survey of corporate directors may be instructive for fund directors, including how self-assessments are being used.

PwC Annual Corporate Director Survey Findings
○ In 2014, 50% of directors said their board made changes as a result of their assessment process. In 2020, that figure was 72%.
○ In response to their last performance assessment, 40% of directors say their boards or committees added additional expertise. Around a third of boards also react to assessments by changing the composition of their committees (32% in 2020, up from 20% in 2014).
○ 20 percent of directors say board leadership is unwilling to have difficult conversations with underperforming directors.
○ In 2020, about half (49%) of directors surveyed say that at least one director on their board should be replaced. Twenty-one percent (21%) say that two or more directors should go.

IV. Asking the Right Questions

Several key areas are common to boards of different sizes and types. Beyond the SEC-mandated inquiries regarding the number of funds overseen by the board and the board's committee structure, the questions and topics below are items that a board may consider. The list is not exhaustive and not all of the areas are relevant to all funds.

Questions and Topics for Evaluation

Meeting Process	***Number of Funds Overseen by the Board***	***Board Information***
o Whether the number, frequency, and locations of board meetings are appropriate o Whether certain meetings can be virtual and others in-person and whether the mix of virtual and in-person meetings is appropriate o Adequacy of length of meetings to cover all necessary information o Appropriateness of agenda items, time allotted to various topics, sufficiency of board input as to agenda items o Amount of meaningful participation from all board members, openness of communication, and timely action o Adequacy of executive sessions and whether they are constructive and encourage open discussion even in areas where directors may disagree	o Whether, in light of the number of funds and their responsibilities to each fund, directors are able to provide effective oversight for each fund ***Board Composition*** o Whether the board represents a diverse mix of characteristics, experience, and skills appropriate to carry out the board's responsibilities[22] o How well the board reflects gender and ethnic diversity o Whether board members who serve on multiple boards can appropriately commit to their board responsibilities o Appropriateness of the board size to discharge its duties effectively o Appropriateness of the proportion of independent directors to interested directors	o Overall quality and timeliness of information received prior to board meetings o Balance of quantity and quality of information including executive summaries, dashboards, and organization of materials o Quality of information provided related to specific areas, including the advisory contract renewal process, fund performance, compliance, and approval of fund distribution arrangements o Quality of information provided about service providers o Adequacy of information about industry trends and how they impact funds and shareholders o Sufficiency of board access to fund officers between meetings o Whether the board has sufficient access to resources, including counsel, outside auditors, and others outside of board meetings

Questions and Topics for Evaluation		
Committee Structure o Appropriateness of committees, given the fund complex's particular structure o Whether the number, frequency, and length of committee meetings are appropriate o Whether the governing charters provide adequate guidelines for the operation of each committee ***Committee Functioning*** o Whether committee meetings are conducted in a way that encourages communication, participation, and timely action by all members of a committee o Whether committees of the whole or separate concurrent committee meetings are appropriate for the board o Timelines for rotations among committees and/or committee chairs o Whether communication between the committees and the full board is sufficient to allow the full board to take appropriate action and fulfill its fiduciary responsibilities	***Board Accountability*** o Board members' preparedness for meetings o Whether directors have an appropriate understanding of the mutual fund business o Whether the board has a sufficient understanding of fund performance data o Proper time allocation to board-appropriate issues and delegating other items to management o Whether the board effectively uses its chief compliance officer to provide appropriate oversight o Appropriate and timely follow-up on action items from prior meetings o Whether each director understands his/her fiduciary responsibilities and adequately discharges those responsibilities o Adequacy of board guidance to – and oversight of – the investment manager and other relevant service providers	***Other*** o Adequacy and fairness of the present level of the board's compensation o Whether there is open and honest communication between the board and fund management and other service providers o Whether there are any areas where the board feels there is a gap in their knowledge about the funds and the fund industry o Whether the board has considered the necessity of a succession plan o Appropriateness of the board's current policy on director investment in the funds o Whether the process encourages action points to consider what actions, if any, are necessary from the self-assessment process o Whether the process encourages directors to share ways to improve the board's self-assessment

V. Emerging Topics in the Boardroom

Recent global risks and political movements have caused major shifts in corporate culture, priorities, and practices and spurred debate[23] around the expectations and accountability for directors of operating companies. While these broad issues have been more impactful in the corporate governance sphere, fund directors may have an interest in how the adviser and fund service providers are responding to these trends and possible related risks.[24] Prioritizing board education on industry trends and challenges and how they affect funds and the adviser can improve the boards' effectiveness as boards grow more forward-thinking, agile, and adaptable to change. The subject areas described below may not apply to all fund boards and are only a sampling of the topics that are changing the fund industry, attracting attention from regulators, and may increasingly require more education for fund directors. These areas include:

- Crisis preparedness
- Cybersecurity
- Environmental, Social and Governance (ESG)
- Diversity, equity & inclusion.

Crisis Preparedness: Events such as catastrophic weather and the global pandemic and resulting work from home environment forced fund complexes to fine-tune their business continuity planning and to develop agility in their business operations. The recent global pandemic brought about a sudden shift to a virtual environment for fund complexes and boards. By using technology at unprecedented levels, boards were able to shift into a virtual meeting schedule and recruit and onboard new directors using unconventional methods. Despite the readiness that was evident both in the fund industry and among fund boards, directors may wish to critically assess their performance, including how they maintained lines of communication with fund management; fostered board culture, collegiality, and high-quality governance practices; leveraged the available technology; and maintained continuing education, during these challenging periods.

QUESTIONS TO ASK

+ Does the board request and receive reporting from fund management on corporate social responsibility initiatives?

+ Does the board understand management's ESG philosophy and related issues on proxy voting; reputational and compliance risks?

+ Does the board have a clear understanding of the adviser's cyber risk mitigation plan?

+ Does the board have a thorough understanding of the adviser's business continuity plan?

+ Does the board have adequate communication lines with management in times of crisis?

+ Did the board maintain its vigilance in oversight responsibilities during the most recent crisis?

+ Should certain practices from the virtual environment be permanently adapted?

Cybersecurity: Cyberattacks pose more than a reputational risk for firms and can cause widespread financial and other losses to firms and shareholders.[25] Boards may evaluate themselves on their vigilance to educate directors and hold management and service providers accountable for cyber risk preparedness and overall resilience in the face of increasing cyberattacks.

Environmental, Social and Governance (ESG): Corporate social responsibility has risen in importance for all business sectors, as regulators, investors and employees demand that companies commit to certain values. Social movements around equity for historically marginalized groups and high-profile corporate scandals have also led corporations to re-examine how their own cultures could be contributing to problems in society. Additionally, investor demand for ESG products is changing the risk profiles of some fund complexes as they invest in these strategies. Fund boards may wish to consider how these evolving issues may pose reputational and other risks to fund complexes and the boards' role in holding management accountable to the values management espouses to the public.

In response to social movements, more attention is being paid to the demographic diversity in the leadership and staffing ranks of major political, business, educational and other institutions. State regulators have begun setting mandates for demographic diversity on public company boards headquartered in their states. Additionally, certain SEC commissioners have called for added disclosure and reporting from public companies on demographic diversity in their workforce and boards of directors.

Diversity, Equity, and Inclusion. Diversity, equity, and inclusion have also become an important discussion item for fund boards, as directors consider the composition of their own ranks and that of fund complexes. Fund boards have long included questions on director and skillset diversity in their self-assessments, however boards may wish to refresh their approach to thinking about diversity, equity and inclusion and consider adding questions to their self-assessments on diversity related topics such as recruitment strategies, whether all directors' experiences and opinions are utilized, and expanding opportunities for board leadership and chairing of committees.

VI. Process for Board Self-Assessments

The board must determine the appropriate process to use for its self-assessment. Directors should consider the amount of time and resources they can devote to the process, the culture of the board, the board's experience, and counsel's recommendations.

The examples of self-assessment processes discussed in this section do not represent an exhaustive list of possibilities; they provide directors examples of what other boards have found to be effective.[26] Any method the board chooses must provide a mechanism to allow the directors to identify issues and provide an opportunity to improve in those areas. Boards should review their process from time to time.

Effective leadership is key to achieving measurable goals from the assessment process. The evaluation process is often spearheaded by the board chair or the chair of the nominating and governance committee. In some instances, the entire nominating and governance committee may choose to take the lead in driving the self-assessment process by designing and implementing the evaluation (interviews, surveys), determining key objectives and benchmarks to be met, setting the agenda for the evaluations, and involving the appropriate parties whether that may be independent counsel, or a third-party professional services firm. The nominating and governance committee may also choose to revise or overhaul the board evaluation format periodically to prevent the process from becoming tedious and to provide new approaches to assessment categories while encouraging fresh perspectives and feedback from directors. Depending on a board's particular governance structure, *e.g.,* fund boards that do not have a nominating/governance committee, the assessment process may be an opportunity for a greater number of directors to contribute to conducting the evaluation process.

In each of the examples in this section, the independent directors generally have an initial discussion during an executive session of the board. Independent directors then discuss the self-assessment during a meeting of the full board to receive the benefit of input from inside directors on whether the board is functioning as effectively and efficiently as possible.

Discussion Method

Directors generally begin this process by reviewing a list of topics that cover aspects of the board's operation and identifying those items that each director thinks should be topics for a board discussion. Directors are encouraged to identify other important issues for discussion that are not included on the original list circulated to directors. This method allows all directors to have input into the issues that need to be discussed by the board. Those items identified by directors are then put on the agenda and a facilitator leads the discussion. Boards should ensure that the discussion facilitator can be effective if results are to truly represent the board's opinions and perspectives. A common drawback to the discussion method is that the conversation may seem stilted and awkward in an executive session where every director is present. The discussion method may be more successfully implemented at a board retreat or a format that is less structured and time-constrained rather than scheduled into a regular board meeting.

Boards may wish to turn to independent legal counsel to facilitate these discussions. Counsel's ongoing relationship with the board and knowledge of its inner workings may put counsel in a unique position to effectively facilitate these discussions and monitor the ongoing effectiveness and realization of the assessment's goals and objectives throughout the calendar year. Independent legal counsel may sometimes be more skilled in safeguarding the anonymity of the process and addressing any potential issues of privilege.

Pros and Cons of the Discussion Method

Pros	Cons
Can encourage an honest assessment of the board's progress over the last year and help identify areas that the board wishes to improve.	Some directors may be reluctant to share their thoughts on sensitive issues in a group discussion format.
Allow directors to elaborate on their opinions in a way not always practical with written questions.	The success of this format may hinge on the facilitator's effectiveness.

Questionnaire

Many boards use a questionnaire as the starting point for their self-assessments. All board members are asked to complete the questionnaire that may ask directors to evaluate how they are doing on a range of topics or ask directors to identify issues that directors feel should be discussed.[27] Questionnaires also generally include an open-ended question that allows directors to address items that otherwise are not covered by the questionnaire. Open-ended questions may be more effective in identifying issues for further discussion, as questions presented with prepackaged answers can limit candid disclosure. The individual coordinating the process compiles the questionnaire responses and the appropriate party creates an agenda covering those items of concern identified by directors. Boards should work to include a vigorous discussion of questionnaire results to ensure that their practices continue to evolve and improve over time.

Pros and Cons of the Questionnaire Method

Pros	Cons
Questions can be carefully considered and changes can be made as the funds evolve.	If directors are not attentive, over time the use of questionnaires can lead to an overly optimistic outlook on the board's processes.
Questionnaires can allow for quick data gathering that can provide a snapshot view of certain topics.	It may be difficult to solicit concrete suggestions for improvement in written form.

Interviews

Much like the discussion method above, the interview method begins with a list of items for each director to consider. This list is circulated to directors who are encouraged to offer additional suggestions of topics that should be addressed. The interviewer, often independent legal counsel or an appropriate board member, then calls each director individually to discuss how the board is functioning generally, the items on the list, and any other items a particular director would like to discuss. The interviewer then consolidates all of the comments and provides a summary of the results to the board during an executive session. All comments are shared without attribution. It is critical that directors have complete trust in the party conducting the interviews, so that directors can be open and honest in their responses. Additionally, the interviewer must have the ability to interpret the information revealed during the interviews with board members.

Pros and Cons of the Interview Method

Pros	Cons
The interview process allows directors to provide nuances to their opinions that may not be evident from written questionnaire responses.	The interview process can be lengthy, and boards must be willing to commit the necessary time if the process is to be beneficial.
Interviewers can ask follow-up questions that can further illuminate director perspectives on a particular issue.	If conducted by counsel or other paid third-parties, interviews are generally more costly than other methods of conducting the self-assessment process.

VII. Use of Third Parties

A board may choose to involve only directors in its self-assessment process. In these cases, the chair of the board or of the governance committee often will coordinate the process. Other boards may wish to use a third party to aid with the annual self-assessment process. The choice of whether to use a third party, and who that third party should be, is entirely up to the board. Some boards may benefit from the independent perspective of someone who is not a member of the board. An experienced board outsider can also provide a comparison among a number of fund complexes, allowing directors to compare their process with others used in the industry. Further, a third party can provide helpful input on appropriate follow-up in areas where the board may need more information and/or guidance for addressing change. The most widely used third party in the mutual fund context is independent legal counsel to the independent directors.[28] Boards may ask independent legal counsel to serve as facilitator of discussions, conduct interviews and report back to the board. Even in cases where the directors do not rely on independent legal counsel to participate directly in the process, independent legal counsel often drafts the questionnaires used as a basis for the process and tabulates responses.[29]

Less frequently, boards have utilized trade associations, board consultants, and other service providers to conduct board self-evaluations.[30] The practice of using third parties is more common among public company boards. Consulting firms' distance from board members may in some cases result in greater objectivity during the evaluation process. However, boards may wish to consider the consultants' relationship and knowledge of the board, the consultants' familiarity with the fund regulatory regime and SEC requirements, and how tailored the consultants' process will be to the board's unique characteristics.

VIII. Individual Director Evaluations

SEC rules require only a board level annual assessment. Whether or not to conduct individual evaluations must be carefully considered on a board-by-board basis, considering the personality of the board members and the board's working style. Boards that have used individual self-evaluations have found them helpful in identifying whether board members have the right skill sets to perform their duties and whether members need additional coaching or training. Individual directors can be evaluated using self-assessments (directors evaluate their own performance) and/or peer evaluations (directors evaluate other directors' performance). Corporate boards are more likely to utilize individual director evaluations; approximately half of all S&P 500 boards conducted individual director assessments in 2020.[31] A well-designed individual director assessment can encourage improved collective board performance, enhance individual directors' effectiveness, provide actionable feedback for directors, and yield better results than solutions such as term limits and hiring of additional experts.[32] An individual assessment should aim to let directors know how they are measuring up to expectations of board service and identify how they can best contribute to overall board effectiveness. Categories for individual assessments can include:[33]

PwC Categories for Individual Assessment	
○ Meeting attendance	○ Understanding of company and industry
○ Degree of preparation	○ Ability to work with directors and management
○ Active participation during meetings	○ Emphasis on skillset and what the director does well
○ Ability to communicate and express ideas	○ What the director should do differently
○ Willingness to listen and acknowledge other viewpoints	○ Overall level of contribution

Individual Self-Assessments

Self-evaluations can only be effective if the individual board members are willing to be completely honest about their contributions to the board. The process of self-evaluation is meant to encourage introspection on skills and qualifications of the individual. In order to encourage honest feedback, responses should not be shared with the board as a whole. Individual self-evaluations may be conducted using a questionnaire or interview process. In light of the dramatic changes in the mutual fund industry, individual self-evaluations may provide directors with a mechanism to reevaluate their effectiveness in an ever-changing environment.

Boards that determine it is in their best interest to conduct individual director evaluations might consider the following areas for evaluation:

The director's understanding of the legal and fiduciary responsibilities of a fund director	The director's ability to work with other directors and management
The director's understanding of the fund's business and the fund industry as a whole	The director's participation level in board and committee meetings
The director's preparation for meetings	The impact of the director's outside interests and business activities on that director's independence, capacity, and commitment to fund oversight
The director's attendance at meetings	The director's overall contribution to the board and its committees

Peer Evaluations

Peer evaluations can yield some good results yet, their potential to disrupt collegiality have made these evaluations unpopular among fund boards. The board needs to make sure that peer evaluations do not grow contentious, needlessly target any particular director, nor provide a forum to air personality conflicts. Further, the board needs to be satisfied that its directors will honestly evaluate the other board members, especially if they have concerns about one particular director's commitment.

Much like the individual self-evaluation process, boards can use either a questionnaire or interview process for peer evaluations. The process should focus on generating constructive comments that will have a positive impact on the board's culture. The identity of commenters should be kept confidential, and once the comments are aggregated and synthesized the results can be shared with individual directors without attribution, to reduce the risk that any director will be alienated as a result of the process.

Peer evaluations can often succeed in a healthy and dynamic board culture. A board culture that prioritizes healthy debate, inclusive participation and collaboration can greatly benefit from candid peer evaluations.

IX. Outcomes and Follow-Up

Once directors identify areas for possible change, they may develop a plan to address those issues over the coming year. Self-assessments that provide evaluation but no mechanism for follow-up will not allow directors the appropriate opportunity to improve their processes over time. Boards can develop an informal action plan as well as a timeline for items that the board feels needs to be addressed. Responsibilities can be assigned to directors, board committees, the chief compliance officer, management, or other appropriate parties. The board might wish to review the action items periodically and/or add to committee agendas as appropriate to ensure that the board continues to monitor its progress throughout the year. Improvements implemented by boards as a result of the self-assessment process may include some of the following initiatives that have resulted in improved effectiveness for some boards:

- Requiring continuing education programs
- Developing plans for crisis and disruptions
- Creating a process to ease onboarding of new directors
- Realigning the board, including the addition of new board members and the retirement of existing directors
- Scheduling a board retreat to address collegiality and communication issues
- Hiring an independent facilitator to refresh the assessment process
- Holding more frequent executive sessions
- Instituting formal mentoring programs
- Adding and consolidating board committees
- Developing management presentations on areas of concern to the board
- Tailoring activities of board committees to make them more effective
- Using technology to make meetings more effective
- Improving succession planning that may include diversity goals
- Appointing vice chairs to board committees to facilitate succession planning;
- Streamlining board materials
- Improving communication with the chief compliance officer and management

X. Conclusion

A board self-assessment is not a one-size fits all exercise. Regulations allow directors to craft a self-assessment that is most appropriate for their particular board. Directors should embrace the annual review as an opportunity to compare their progress from year to year and make changes to better serve fund shareholders. Boards routinely report improvements in operations as a direct result of issues and opportunities identified during board self-assessments. Ideally, every board member will have a genuine commitment to the process. Boards should set long-term goals and review their processes throughout the year to ensure that the board continues to evolve over time and does not become complacent about its governance.

XI. Contributors

PwC

Patricia Flynn, PhD., Trustee Professor of Economics & Management at Bentley University, and Independent Director.

XII. Endnotes

[1] *See Investment Company Governance*, Rel. No. IC-36520 (July 27, 2004) ("Adopting Release"). *See also* Rule 0-1(a)(7)(v) under the Investment Company Act of 1940.

[2] This report was developed by leaders in the independent director community with advice given by members of the Forum's Steering Committee, with extensive assistance from PricewaterhouseCoopers LLP and Independent Director and Professor Patricia Flynn. Members of the Forum's Board Effectiveness Working Group participated in the report in their individual capacities, and not as representatives of their organizations, the fund boards on which they serve, or the funds themselves. Drafts of this report were reviewed by the Forum's Board of Directors and Steering Committee, and their comments have been integrated into this document. The report does not necessarily represent the views of all Forum members in every respect.

[3] *See* Fund Boards Can Find Ideas in Corporate Board Practices, By Whitney Curry Wimbish February 9, 2021. BoardIQ. Available at https://www.boardiq.com/c/3053913/385593/fund_boards_find_ideas_corporate_board_practices?referrer_module=issueHeadline&module_order=5.

[4] *See* Getting Real Value from Board Assessments, PwC Governance Insights Center. Available at https://www.pwc.com/us/en/governance-insights-center/publications/assets/pwc-getting-real-value-from-board-assessments.pdf.

[5] *See* Board and Director Assessments That Matter, by Jack "Rusty" O'Kelley III, Justus O'Brien, Laura Sanderson, PJ Neal Russell Reynolds Associates, January 21, 2020. Available at https://www.russellreynolds.com/insights/thought-leadership/board-and-director-assessments-that-matter.

[6] *See* PwC's 2020 Annual Corporate Directors Survey, Turning Crisis Into Opportunity. Available at https://www.pwc.com/us/en/services/governance-insights-center/library/annual-corporate-directors-survey.html.

[7] *See* Adopting Release.

[8] *See* Rule 0-1(a)(7)(v) under the Investment Company Act of 1940.

[9] *See id.* at 3.

[10] *See Investment Company Governance*, Rel. No. IC-26323 (January 15, 2004) ("Proposing Release").

[11] *See id.*

[12] In addition to the SEC's requirement, the New York Stock Exchange requires exchange listed closed-end funds to periodically review the performance of their audit committees. *See* New York Stock Exchange Rule 303A.07(c)(ii).

[13] *See* Adopting Release at 9. This requirement is "designed to focus the board's attention on the need to create, consolidate, or revise the board's committees and to facilitate a critical assessment of the effectiveness of the current board committees." (Adopting Release at footnote 62) *See also* Rule 0-1(7)(v).

[14] *See id.*

[15] *See* Adopting Release at 9. *See also* Proposing Release. *See also* Rule 0-1(7)(v).

[16] *See* Adopting Release at 9. The SEC imposed this requirement because of the difficulty in prescribing an optimum number of funds that may be overseen by a group of directors.

[17] *See* Conducting Effective Board Assessments, PwC Governance Insights Center. Available at https://www.pwc.com/us/en/governance-insights-center/publications/assets/pwc-conducting-effective-board-assessments.pdf.

[18] *See* For Some, Self-Assessments Need Their Own Assessment, By Greg Saitz, BoardIQ, February 9, 2021. Available at https://www.boardiq.com/c/3053653/385593/some_self_assessments_need_their_assessment?referrer_module=issueHeadline&module_order=4.

[19] *See,* Note 6.

[20] Id.

[21] *See* Note 19.

[22] This issue may be particularly important to boards of small funds because the SEC mandated considerations may be less relevant to these boards. It is vital that boards of all sizes consider if any gaps exist in the skill sets of the boards and how best to fill those gaps, including education, training or other appropriate methods.

[23] See Boards Beware: Accountability is Rising. Academics and lawyers actively debating to whom the law "says" boards and CEOs have a duty -- whether it is the shareholders, a mix of stakeholders, the corporation itself, or some combination thereof. Available at https://corpgov.law.harvard.edu/2020/12/05/boards-beware-accountability-is-rising/.

[24] In PwC's 2020 Board Effectiveness Survey public company executives gave their boards low marks on certain subject areas such as IT/Technology, cybersecurity, crisis preparedness, and ESG. Available at https://www.pwc.com/us/en/services/governance-insights-center/pwc-board-effectiveness-a-survey-of-the-c-suite-final.pdf.

[25] *See* Investors Are Worried About Cybersecurity: What Boards Should Do? By Jake Olcott. September 30, 2020, NACD BoardTalk. Available at https://blog.nacdonline.org/posts/investors-worried-cybersecurity-boards.

[26] For a discussion of these methods in corporate audit committees, *see PwC Audit Committee Excellence Series*. Available at https://www.pwc.com/us/en/services/governance-insights-center/library/audit-committee-excellence.html.

[27] Questionnaires asking directors to identify items that should be discussed by the board are often used as a basis for the discussion method.

[28] The board should ensure that counsel is kept well-informed about the board self-assessment, whether or not counsel is directly involved in the process.

[29] Though some boards may use counsel to the independent directors with the hope that the results of the process will be protected by attorney-client privilege, many lawyers agree that these types of communications may be discoverable.

[30] *See Spencer Stuart Board Index 2020*. The survey indicates that of the 98% of S&P 500 boards that report conducting some sort of annual performance evaluation 44% disclosed that they have some form

of individual director evaluations; 21% of boards disclosed they engaged an independent third-party governance expert to facilitate the evaluation process. Available at https://www.spencerstuart.com/-/media/2020/december/ssbi2020/2020_us_spencer_stuart_board_index.pdf.

[31] *See* Conducting Effective Board Assessments. PwC Governance Insights Center, June 2020. Available at https://www.pwc.com/us/en/services/governance-insights-center/library/conducting-effective-board-assessments.html.

[32] *See* Individual Director Assessments Posted by Rusty O'Kelley (Russelll Reynolds Associates) and Matteo Tonello (The Conference Board, Inc.), on Sunday, July 21, 2019. Available at https://corpgov.law.harvard.edu/2019/07/21/individual-director-assessments/.

[33] *See* Note 31.