Supersize It? Legg Board Combo Would Create a Big One

By Nick Godt March 23, 2021

With **Franklin** and **Legg Mason** joining a growing list of firms consolidating their funds boards, questions are coming up about the ideal board size, lawyers and governance experts say.

On the one hand, Franklin Templeton, which acquired Legg Mason in July 2020, plans to combine oversight of the two firms' lines of ETFs under one roof. The groups plan to have Franklin's ETF board, composed of one interested and three independent directors, take over for the 10 directors now overseeing the Legg Mason ETF Investment Trust.

Legg Mason, meanwhile, is asking shareholders to approve consolidating two of its cluster boards. The first board, which oversees the Legg Mason Partners Equity Trust's 16 funds and the Variable Equity Trust's 23 funds, is composed of the same 10 directors who oversee the group's ETFs. The second, the Legg Mason Global Asset Management Trust, oversees 20 funds and is composed of nine directors, six of whom will retire. The proposed combined board would have 13 directors, including one interested member, to oversee all 59 funds.

Legg had already started consolidating its boards in early 2020, after winning approval to merge the **Western Assets Funds** board with the Legg Mason Partners Income Trust one.

Combining a complex's cluster boards to have fewer directors oversee a larger number of funds has become a growing trend in the past decade.

Late last year, two boards in the **Columbia Funds** complex announced plans to merge into the largest board in the industry with 16 directors overseeing over $300 billion in assets. The **Invesco** board, which had brought in five directors from **OppenheimerFunds** following its acquisition, also had 16 directors until two of them retired late last year. The **Virtus** board, the **BlackRock** Multi-Asset complex board, a **Fidelity** board and the **Principal Funds** board each have 12 independent directors.

Board consolidations are a consequence of the slew of mergers among fund shops, a trend itself driven by industrywide pressure to lower fees and reduce costs, lawyers and industry observers say.

“This is a mature industry, and like all mature industries, there's a lot of competition, including in recent years, on pricing,” says Robert Kurucza, a partner at **Seward & Kissel**. “Building scale and driving efficiency through combinations has become necessary to be more profitable. It also means more assets under management that need to be managed more effectively.”

Board consolidations achieve that efficiency through centralized oversight and increased bargaining power with vendors and distributors, according to Bridget Hughes, director of parent research at **Morningstar**. Having uniform views on fees and distribution payments also facilitates accountability to shareholders, she says.

At the same time, advances in technology during the past decade allow boards to centralize oversight of funds more easily.

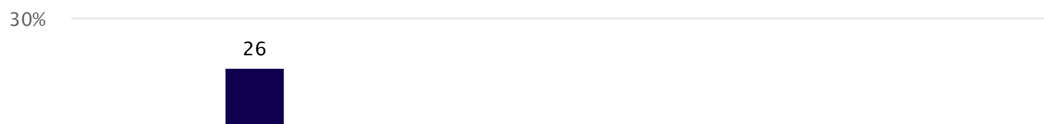
“There was a time when it was accepted that a board shouldn’t oversee too many funds,” says Jay Keeshan, a partner at consulting firm **Management Practice**. “But tech has made it easier to achieve efficiency, governance has evolved and expenses have become more transparent.”

Yet determining the ideal size of these combined boards remains a work in progress.

Some 51% of 396 boards surveyed by Management Practice in 2020 had between three and five independent directors.

How Many Members on the Board?

Management Practice surveyed 396 boards last year about board size. The largest percentage had three members.



And while the larger boards resulting from combinations at Legg, Columbia, Invesco and others have drawn attention, they’re not necessarily the norm. The increased pace of merger activity may be boosting some board’s head counts, but only 3% of the boards Management Practice surveyed last year had 11 or more independent directors.

The key to successful board combinations may not be simply in the number of directors involved.

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“From a governance perspective, there’s no one-size-fits-all,” Seward & Kissel’s Kurucza says. “In my experience, what’s effective is what works.”

Since the announcement of the Franklin-Legg tie-up last year, Franklin executives have emphasized their intention to keep product lines separate and preserve the autonomy of various affiliates. Board combinations that gather many product lines under one roof might seem to contradict that aim.

It might be that having separate boards is the best option to preserve investment specializations, Kurucza says. But if enough synergies have been identified to warrant a single board, splitting up oversight of different products between directors and committees might be the way to go.

In Legg’s latest proposal, the two existing boards cite a number of reasons for approving the combination, including increased oversight of the funds, the added experience and various skill sets of the proposed directors, and lower cost per funds than the current expenses of fund governance. In 2020, the funds paid the 19 directors on the two Legg boards a combined $6.3 million, according to filings.

After a merger, it’s not unusual to obtain a larger board with a number of directors that is above “the optimal size” for a while, says Keeshan, from Management Practice. “What you get is a lot of institutional experience to deal with different kinds of funds,” he says. “During the transition period, [the directors] can evaluate the dynamics of the funds being overseen, and over time, you eventually have attrition.”

The two combining Legg boards anticipate a number of vacancies to occur in the next several years due to scheduled retirements, according to the proxy.

The average age of the proposed directors for the combined Legg board is 75, including three in their 80s, and their average tenure is more than 28 years. Industrywide, the average age on fund boards is 67, according to the Management Practice 2020 survey.

Long tenures on boards are common, and the accumulated knowledge and experience tend to benefit funds and shareholders, governance experts say. If a slew of retirements are looming, however, it's important to keep tabs on what "each director is bringing to the table," Morningstar's Hughes says.

Keeping a larger board, at least for a time, allows for some of that experience to be shared. It also postpones the tensions around aging board members having to give up what is often lucrative compensation for their long commitment, Hughes says.

Meanwhile, the six directors retiring from the Legg board are each receiving between $101,500 and $111,500 "in recognition of their retirement," the proxy says. The amounts are equal to what the directors would have received had they stayed until the end of 2021. Franklin Templeton will reimburse the funds for these payments, according to the proxy.

"It's a little weird to me," says Hughes. "Board seats should not be guaranteed."

In the interim, larger boards also provide an opportunity to boost diversity, governance experts say.

"What you want in a really good board is diversity of thought and experience and, as is now mandated in California, of race and gender," says Niels Holch, executive director of the Coalition of Mutual Fund Investors.

Meeting diversity requirements adds pressure on boards to grow larger, Holch says. But beyond a certain size, a board runs the risk of creating factions and having a harder time reaching consensus.

"It's easier to work with 10 people than with 20," Holch says. For efficiency and harmonization to occur, "what's needed is a merging of cultures and strengths so that the whole is better than the sum of the parts."

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