John Hancock Investment Management

Quarterly conversations

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Hassell H. McClellan

Chairperson,
John Hancock Group of Funds
Board of Trustees

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—Hassell McClellan

Being a fund fiduciary: what it means and why it matters

We sat down with Hassell McClellan to talk about the role played by the board as a fiduciary working on behalf of John Hancock fund shareholders.

Q: When we talk about the Board of Trustees of the John Hancock Group of Funds having a fiduciary responsibility to shareholders, what do we mean?

A: As the chair of the board, along with my fellow board members, we have a responsibility to adhere to two basic tenets with respect to fund shareholders: the duty of care and the duty of loyalty. These are centrally important ideas of fiduciary responsibility that are enshrined in legal definitions and judicial precedent.

Essentially, in overseeing the performance and operations of the funds, we must endeavor to act in the best interests of shareholders at all times—that's the duty of care. It also means we must act with no conflicts—that's the duty of loyalty. We're not acting in our own best interests or those of the investment manager, whether we're talking about John Hancock Investment Management or one of the 23 subadvisors who manage money for John Hancock fund shareholders. Our sole responsibility is to ensure that we're acting on behalf of the *shareholders* in whatever we decide and whatever we do.

Q: How does that translate into the day-to-day activities you pursue as a board?

A: The board is an independent body. Everything we do by way of monitoring subadvisors and working with the investment management company, John Hancock Investment Management, is suffused with the same principles of duty of care and loyalty. The bulk of our time is spent overseeing the funds, from how they operate and apply fees to the way they deliver risk-adjusted performance, and this oversight is conducted entirely on shareholders' behalf, while keeping their best interests in mind.

Working together with teams from John Hancock Investment Management, the individual subadvisors, our outside legal counsel, and independent auditors, we conduct formal reviews of the funds on a quarterly basis. This includes looking at peer-relative data and considering whether a fund's scale might support fee reductions or breakpoints for investors. On an annual basis, we conduct on-site visits with most subadvisors—and we're looking forward to doing so again, switching from virtual-only meetings as COVID-19 subsides.

Overall, we look for consistency: What does a fund's process and investment philosophy state that it will do, and how well are the fund's results explained by that process and philosophy.

Q: Does that mean if a fund performs poorly, that's a red flag?

A: It means that if a fund performs poorly *or inordinately well*, but the managers didn't stick to their process, then there's a red flag. Consistency doesn't mean turning out great performance all the time.

Every fund's performance should conform to what's sometimes called the fund's performance blueprint. We should generally know how a fund will invest and how it's likely to perform given certain market conditions and in certain phases of the business cycle. And we look at a fund's performance relative to benchmarks and peer groups. Assuming the subadvisor is taking an appropriate level of risk in line with its investment strategy, and doing so competently, then a fund's performance should correspond to its stated investment objectives or performance blueprint and it should deliver an intelligible relative result—relative to benchmarks and peers. Anomalies can occur, of course, but that's part of our charge—to determine whether something that went too wrong (or too right) was just a glitch or was more indicative of an underlying problem. If we see a fund drifting away from its stated style and prospectus-based objectives, or we start to see the subadvisor acting opportunistically in a way that's contrary to its stated investment philosophy, that's more concerning.

Q: If you're monitoring the funds, and by extension the subadvisors, who's monitoring you?

A: That's a good question. Any mutual fund board is held accountable in a number of ways. Because John Hancock Funds is a so-called '40 Act company—a reference to the Investment Company Act of 1940—we're regulated by the Securities and Exchange Commission (SEC), which lays out principles and best practices for conducting fund oversight and monitoring. The fund's compliance team then works to help ensure that we adhere to all aspects of fiduciary responsibility, providing services and decision-making that are directed at all times at benefiting shareholders.

One of the points stipulated by the SEC is that boards should include independent trustees. There are 12 members of our board—10 of whom are independent, which means they're not formally connected to John Hancock Investment Management. The two people who aren't independent are Andy Arnott and Marianne Harrison, the CEOs of John Hancock Investment Management and John Hancock Financial, respectively. But the independent members aren't part of the investment management company or any of the subadvisors, and this is a condition of the duty of loyalty—acting without conflict.

As a matter of solemn principle, independent board members don't own Manulife stock or any stock in any of the subadvisors because we don't want to be influenced—or even merely appear be able to be influenced—in any way by virtue of a financial connection. That said, every trustee on the board, including Andy and Marianne, owns shares of the John Hancock Funds, which further aligns us with the financial interests of the fund shareholders we serve, and this fund ownership is disclosed in each fund's Statement of Additional Information, or SAI, which is publicly available on the website.

Q: So if fiduciary responsibility means acting solely in the interests of shareholders, is the *quality* of the board's decision-making a point that matters as well? In other words, if the board simply believes it's acting in the interests of shareholders but makes, let's say, less than ideal decisions, can we still say it's fulfilling its fiduciary responsibility?

A: Is this a trick question? The John Hancock board *always* makes the right decisions!

I jest. You raise a fair point, actually, because another important aspect of fiduciary responsibility is prudence—a principle enshrined in the prudent man rule, which was first articulated in an 1830 Massachusetts court case. In it, the judge essentially wrote that fiduciaries must act as a prudent person would act with respect to investing his or her own property, while considering the needs of beneficiaries and the preservation of the estate. So each of our decisions as a board must conform with the notion of prudence. Bottom line, are we making decisions that a prudent person would make given our responsibilities as a fiduciary? If the answer is yes, then we're acting prudently and in good faith.

That doesn't mean that what counts as acting prudently is beyond interpretation. Investors sometimes appeal to the courts to judge whether their fiduciary acted prudently. But even if a fiduciary's decision turns out to have been the wrong move, if the decision was made in a prudent manner, then that will guide judicial oversight of questions of breaches of fiduciary trust.

Q: What do you see as some of the key challenges that mutual fund boards will face in the coming years?

A: For many mutual fund boards in the United States today, the next four to five years could see relatively significant turnover in trustees, given the age of many board members. So a key challenge will be thinking about and helping establish the future composition of the board, which means finding suitable replacements for retiring board members. As we think about the needs of fund shareholders, we must think about the future state of skills and expertise that the board will be able to offer and need. In other words, we have to think about how to replace the key skills of retiring board members as well as add new skills and attributes that can enhance what we already have as a team.

Of primary concern here is the technological paradigm shifts that continue to transform financial markets and global communications. Many of the issues that boards are dealing with today are different from the kind of issues that many of us were facing when we came on the board 10 to 15 years ago. In decades past, the largest companies in the world tended to be industrial companies, financials, and consumer companies. But the dominance of old economy stocks has waned, and the rise of information technology has accelerated in the past 15 years. The largest companies today—which in many ways have reshaped more than just the markets but the entire global economy—present different kinds of challenges and needs. Cybersecurity is a crucial aspect of this, because ensuring the security of shareholder information as well as the security of information pertaining to the funds' investments is a much different and more difficult task than it was in the past.

Also, we'll continue to see crises emerge that are different from past crises. The pandemic is a good example. Companies are working differently as a result, and that extends to how boards may operate in the years ahead, adapting to the challenges and opportunities of virtual techniques for accomplishing the day-to-day tasks and long-term objectives of fund governance and the exercise of our fiduciary responsibility to shareholders.

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