MEMO# 20761

January 5, 2007

SEC Releases Staff Economic Papers Relating to Fund Governance

[20761]

January 5, 2007

TO: BOARD OF GOVERNORS No. 2-07
CLOSED-END INVESTMENT COMPANY MEMBERS No. 3-07
SEC RULES MEMBERS No. 3-07
SMALL FUNDS MEMBERS No. 3-07 RE: SEC RELEASES STAFF ECONOMIC PAPERS RELATING TO FUND GOVERNANCE

As we previously reported, the Securities and Exchange Commission recently reopened the comment period on its June 2006 request for additional comment on the independent chair and 75% board independence requirements. [1] The Commission did so to permit public comment on two papers prepared by its Office of Economic Analysis (OEA) that relate to issues regarding mutual fund board independence. [2] This memorandum briefly summarizes the OEA's papers. Comments on the papers are due to the SEC by March 2, 2007.

The first paper is entitled Literature Review on Independent Mutual Fund Chairs and Directors. It describes the literature in financial economics that relates to mutual fund governance. The paper notes that economic theory provides no clear guidance as to the best structure of a fund board, either in terms of board chair status or the percent of directors who are independent. The paper notes that what works for one fund (or operating company) may not be appropriate for another. The paper also states that the empirical data does not clearly indicate the superiority of any particular board arrangement. For example, the paper notes that studies have indicated that "boards with a greater proportion of independent directors are more likely to negotiate and approve lower fees." On the other hand, the paper indicates that there is no consistent evidence that funds with independent chairs have either lower fees or better performance.

The second paper, entitled Power Study as Related to Independent Mutual Fund Chairs, examines three recent studies that have concluded that there are no demonstrable economic benefits to having an independent board chair. These three studies analyzed the influence of board chair status on fund performance, fund fees, and the likelihood of being implicated in the late-trading/market-timing matters. The studies concluded that there is no relationship between a fund's board being led by an independent chair and better outcomes for the fund's investors along these dimensions. The paper argues that it still may be the case that an independent board chair would lead to superior outcomes, but that such a result is difficult to pinpoint because of the limits of data and statistics.

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endnotes

[1] See Memorandum to Board of Governors No. 32-06, Closed-End Investment Company Members No. 62-06, SEC Rules Members No. 108-06, Small Fund Members No. 86-06 [20698] (December 18, 2006).

[2] The papers can be found on the SEC's website at http://www.sec.gov/rules/proposed/s70304/oeamemo122906-litreview.pdf and http://www.sec.gov/rules/proposed/s70304/oeamemo122906-powerstudy.pdf.