

MEMO# 18827

May 3, 2005

SEC RELEASES INDEPENDENT CHAIR REPORT TO CONGRESS

©2005 Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice. [18827] May 3, 2005 TO: BOARD OF GOVERNORS No. 18-05 CLOSED-END INVESTMENT COMPANY MEMBERS No. 24-05 INVESTMENT COMPANY DIRECTORS No. 10-05 SEC RULES MEMBERS No. 55-05 SMALL FUNDS MEMBERS No. 38-05 RE: SEC RELEASES INDEPENDENT CHAIR REPORT TO CONGRESS The Securities and Exchange Commission released a report to Congress regarding the independent chair condition of the Commission's 2004 exemptive rule amendments.¹ The report was issued in accordance with the Consolidated Appropriations Act, 2005, which required the Commission to submit a report to the Senate Appropriations Committee that (i) provides a justification for the final rules issued by the Commission requiring, as a condition for reliance on ten exemptive rules adopted by the Commission, that a mutual fund's board of directors be chaired by an independent director; and (ii) analyzes whether mutual funds chaired by independent directors perform better, have lower expenses, or have better compliance records than mutual funds chaired by interested directors. The report contains a discussion of mutual fund governance and conflicts of interest, including the conflicts of interest of fund advisers and service providers, how the Investment Company Act protects funds from conflicts of interest, and the responsibility of fund directors to address conflicts of interest. The report also details the exemptive rules and the importance of director involvement in monitoring closely fund activities under the rules. The report then discusses recent mutual fund scandals involving market timing, late trading, selective disclosure of fund portfolio holdings and undisclosed revenue sharing and directed brokerage, as well as the Commission's enforcement response. Next, the report details the independent chair condition of the 2004 exemptive rule amendments and provides an analysis of the relationship between independent chairs and fund performance, expenses and compliance. Finally, the report recommends that the Commission and its staff should continue to monitor how the presence of an independent chair on the board changes the independence and effectiveness of the board, especially in the context of other recently adopted regulatory changes. In a separate letter to the Chairman of the Senate Appropriations Committee, Commissioners Glassman and Atkins expressed their belief that the report fails to respond constructively to Congress's inquiry and offers no evidence to support its premises.² Jane G. Heinrichs Assistant Counsel

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