

**MEMO# 11399**

November 9, 1999

## **ROYE ADDRESSES 1999 INVESTMENT COMPANY DIRECTORS CONFERENCE**

[11399] November 9, 1999 TO: BOARD OF GOVERNORS No. 71-99 INVESTMENT COMPANY DIRECTORS No. 12-99 SEC RULES MEMBERS No. 68-99 SMALL FUNDS MEMBERS No. 12-99 RE: ROYE ADDRESSES 1999 INVESTMENT COMPANY DIRECTORS CONFERENCE

Paul Roye, Director of the Securities and Exchange Commission's Division of Investment Management, spoke at the Institute's 1999 Investment Company Directors Conference on October 28, 1999. Mr. Roye's speech focused on the Commission's independent fund directors initiative, which includes proposed rule amendments to enhance the independence and effectiveness of independent directors, and staff interpretive positions designed to enhance the position of independent directors. A copy of Mr. Roye's speech is attached and is summarized below. Mr. Roye applauded the Institute's efforts to enhance the effectiveness of fund directors by establishing an Advisory Group on Best Practices for Fund Directors. Roye noted that the "best practices" recommendations issued by the Advisory Group illustrate the industry's willingness to further empower independent directors, and urged attendees to give "serious consideration to implementation of the best practices." Roye explained that the Commission was proposing its own reforms in addition to the best practices recommendations to provide "a baseline standard which all funds should meet [and which] carry the force of law." Mr. Roye proceeded to address the Commission's major rule proposals. **Proposals Tied to Popular Exemptive Rules** Mr. Roye explained that under the Commission's proposals, funds that rely on any of ten commonly used exemptive rules would be required to have boards with a majority of independent directors, to have independent directors select and nominate new independent directors, and to have independent legal counsel for the independent directors. Mr. Roye noted that the Commission believes that "a fund board that has at least a majority of independent directors is better equipped to perform its duties and responsibilities." He also said that while the Commission recognizes that most funds' boards are already composed of a majority of independent directors, they believe that all funds relying on certain conflict-related rules should be availed of this significant protection. In support of the Commission's self-nomination proposal, Mr. Roye stated that the proposed selection and nomination process should give boards an opportunity to consider selecting director candidates whose backgrounds, skills and experience will complement those of existing board members, and enhance the autonomy from management on the part of independent board members. Finally, Mr. Roye explained that the proposals relating to counsel would encourage, but not require, independent directors to use independent legal counsel. He stated that independent directors would be well served by the assistance of a legal counsel that is truly independent of fund management, especially due to the conflicts of interest that arise between a fund and its management. Mr. Roye expressed his belief that this was one of the

strongest pieces of the Commission's proposal. Other Major Proposals Mr. Roye addressed three other major aspects of the Commission's rule proposals, but not those proposed provisions regarding disclosure of information about fund directors. He noted that the proposals also seek to enhance director independence by encouraging the development of fund audit committees comprised entirely of independent directors. The proposals also would prohibit joint fund D&O/E&O insurance policies from containing "insured versus insured" exclusions, which potentially could exclude claims made by independent directors when they are sued by their fund's adviser. Finally, Mr. Roye noted that the proposal contains rules and rule amendments designed to provide qualified individuals from unnecessarily being disqualified from serving as independent directors. Staff Interpretations Mr. Roye explained that, along with the rule proposals issued for comment, the staff of the Commission published several staff interpretive positions designed to enhance the position of independent directors. He noted that one interpretive position clarifies that actions taken by fund directors that are within the scope of their duties as directors do not constitute prohibited "joint transactions" under the 1940 Act. Roye stated that another staff interpretation addresses when a fund may advance legal fees to its directors in light of the 1940 Act's limits on indemnification of legal fees for willful misfeasance, bad faith, gross negligence or reckless disregard of duties. He also noted that the staff has provided guidance concerning when and how mutual funds may compensate directors with fund shares. Mr. Roye further explained that the interpretive release sets forth a position issued by the Commission concerning the Commission's role in disputes between independent directors and fund management. Roye noted that, while as a matter of policy the Commission is limited in its ability to comment publicly on allegations of wrongdoing, the Commission takes all allegations of wrongdoing seriously, especially those asserted by independent directors. Doretha VanSlyke Zornada Assistant Counsel Attachment Note: Not all recipients receive the attachment. To obtain a copy of the attachment referred to in this Memo, please call the ICI Library at (202) 326-8304, and ask for attachment number 11399. ICI Members may retrieve this Memo and its attachment from ICINet (<http://members.ici.org>).