

MEMO# 20224

July 31, 2006

Draft ICI Comment Letter on SEC Fund Governance Rules; Conference Call August 10th

©2006 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. [20224] July 31, 2006 TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 22-06 SEC RULES COMMITTEE No. 34-06 SMALL FUNDS COMMITTEE No. 17-06 RE: DRAFT ICI COMMENT LETTER ON SEC FUND GOVERNANCE RULES; CONFERENCE CALL AUGUST 10TH As we indicated previously, the Securities and Exchange Commission has requested additional comments on requirements that investment companies relying on certain exemptive rules have a board with (1) no less than 75 percent independent directors and (2) an independent director as chair.¹ The Institute has prepared a draft comment letter, which is attached and summarized below.² The Institute will hold a conference call on Thursday, August 10th at 3:00 p.m. Eastern time to discuss the draft letter. The dial-in number for the call is 800-857-5485 and the passcode is 46528. Please email Barbara Watkins at bwatkins@ici.org to let us know if you plan to participate on the call. If you cannot participate on the call, please provide any comments on the draft letter to Frances Stadler at frances@ici.org or 202/326-5822 before the call.

Summary of Draft Letter The draft letter begins by commending the Commission for its announced plan to conduct a top-to-bottom review of its process for complying with legal obligations to analyze the economic impact of proposed rules. The letter states that this initiative has the potential to have a far-reaching positive impact on the way the Commission operates that will serve the Commission, the public, the securities markets and investors for many years to come. 1 See Memorandum to Closed-End Investment Company Committee No. 14-06, SEC Rules Committee No. 26-06 and Small Funds Committee No. 15-06 [20107], dated June 15, 2006. 2 We are preparing a separate letter to be submitted on behalf of the Institute's Small Funds Committee. That letter will focus on the disproportionate cost impact of the requirements on small funds. 2 Consistent with the Institute's comments when the Commission first proposed the fund governance requirements, the draft letter recommends that the Commission not pursue the independent chair requirement and that it require two thirds of a board's members to be independent, rather than 75 percent.

Independent Chair The draft letter reasserts the Institute's view that the selection of the best person to serve as chairman rightfully is, and should continue to be, a decision made by the directors themselves. The letter notes that since the Commission first issued its proposal, many fund boards have chosen an independent director as chairman, demonstrating that a legal requirement is not necessary to facilitate this approach. It points out that the independent directors, because they generally must constitute at least a simple majority of the board, are fully empowered to

choose an independent chair if they wish. While acknowledging that an independent chair arrangement works well for some boards, the draft letter states that the Institute does not believe the Commission has adequately demonstrated the benefits of mandating this governance structure for virtually all fund boards. The letter points to the lack of empirical evidence of benefits and discusses developments, including other new rules, that have already addressed the purposes of the independent chair requirement. The letter expresses the Institute's belief that given (1) the lack of empirical evidence of benefits, (2) the other new rules and outside forces that have addressed the Commission's goals, and (3) the successful experiences of boards with each structure, the costs of a one-size-fits-all requirement are not justified. The draft letter then suggests that if the Commission continues to believe that additional measures are needed, it should consider less costly and disruptive alternatives, such as requiring boards that do not have an independent chair to appoint a lead independent director.

Board Composition The draft letter reiterates the Institute's support for requiring a supermajority of independent directors on fund boards. It discusses the costs involved in reaching and maintaining a supermajority of independent directors and provides examples to illustrate that a 75 percent requirement amplifies these costs, most notably in terms of reduced flexibility in board composition. The letter urges the Commission to revise its proposal so as to require a two-thirds supermajority instead of 75 percent because the costs of the 75 percent requirement – both in dollars and decreased flexibility – come without any apparent corresponding benefit.

Frances M. Stadler Deputy Senior Counsel Attachment (in .pdf format)