

ICI Comments on SEC Review of Fund Governance Requirements, June 2005

June 27, 2005

Mr. Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Investment Company Governance; File No. S-7-03-04

Dear Mr. Katz:

The Investment Company Institute [1](#) understands that the Commission will meet on June 29th to consider fund governance matters that the Court of Appeals for the District of Columbia Circuit recently remanded to the Commission for reconsideration. [2](#) The court has directed the Commission to “address . . . deficiencies” in its consideration of (1) the costs imposed by requiring registered investment companies to have boards that consist of at least 75% independent directors and an independent chairman and (2) reasonable alternatives to the independent chairman requirement.

Under the Administrative Procedure Act and the court’s decision, the Commission has a statutory obligation to consider whether a proposed regulation will promote efficiency, competition, and capital formation. The court’s decision makes clear that the Commission must not only identify potential costs, but also quantify them as part of its analysis under this standard. [3](#) In light of the court’s decision, we recommend that the Commission invite additional public comment and collect additional data to assure a thoughtful and deliberative process.

To assist the Commission in fulfilling its responsibilities under the Administrative Procedure Act, we have identified in the [Appendix](#) to this letter certain foreseeable elements of the cost of complying with the two governance requirements. As the [Appendix](#) indicates, these cost elements are wide-ranging, the evaluation of these costs is a complex undertaking, and total compliance costs may be substantial. Accordingly, we urge the Commission to make a complete and detailed analysis of these costs. We would be pleased to assist the Commission in fulfilling its obligation to quantify these costs by collecting specific cost information from our members relative to the governance requirements.

As required by the court, the Commission also must consider alternatives to the requirement that each fund have an independent chairman, including the disclosure alternative discussed in the court’s decision. Another alternative that we believe deserves careful consideration is requiring the chairman of the board to be elected annually by both a majority of the board as a whole and a majority of the independent directors. To fully satisfy its obligations, the Commission should evaluate not just these but other reasonable alternatives as well.

Please contact me at 326-5815 if you have any questions or we can provide additional information at this time.

Sincerely,

Elizabeth R. Krentzman
General Counsel

cc: The Honorable William H. Donaldson, Chairman
The Honorable Paul Atkins, Commissioner
The Honorable Roel Campos, Commissioner
The Honorable Cynthia A. Glassman, Commissioner

The Honorable Harvey Goldschmid, Commissioner

Giovanni P. Prezioso, General Counsel
Meyer Eisenberg, Deputy General Counsel
and Acting Director, Division of Investment Management

APPENDIX

Representative Cost Elements

75% Independence Requirement (new independent director added)

Initial costs:

Search and selection process:

- The time and expense of additional formal and informal meetings of members of the fund's board and nominating committee
- Additional professional services: assistance of a search firm or consultant; legal counsel review of disinterested status
- Review and, if necessary, amend bylaws and/or corporate charter (e.g., to increase the size of the board)

Shareholder vote for new director⁴ and, if required, to amend charter:

- Preparation of proxy materials and solicitation of proxies/obtaining a quorum, meeting of shareholders (these efforts will require substantial assistance from professional experts, including in-house counsel and independent legal counsel)

Board transition:

- Orientation and education
- Committee (re)assignments

Investor communications:

- Revise and file with SEC, as necessary, disclosure documents and other investor communications to reflect new board composition

Ongoing costs:

- Compensation and benefits for, and expenses (such as travel expenses) of, additional independent director
- Insurance premiums
- Professional development

Independent Chairman Requirement (all costs above apply if a new director will serve as independent chair)

Initial costs:

Selection process:

- The time and expense of additional formal and informal meetings of members of the fund's board and nominating committee
- Review and, if necessary, amend bylaws and/or corporate charter (e.g., where existing documents provide that the chairman must be an officer of the fund)

Shareholder vote to amend charter, if required:

- Preparation of proxy materials and solicitation of proxies/obtaining a quorum, meeting of shareholders (these efforts will require substantial assistance from professional experts, including in-house counsel and independent legal counsel)

Chairman transition:

- Orientation and education to assume new responsibilities

Investor communications:

- Revise and file with SEC, as necessary, disclosure documents and other investor communications to reflect new board composition
- Response to changes in corporate governance structure (phone, email, mail)

Ongoing costs:

- Increased compensation and possibly benefits, in light of increased responsibilities (time and opportunity costs) and potential increased liability risk
- Potential employment of administrative and/or other dedicated staff (salaries, benefits, training, office space, technology support, etc.)

ENDNOTES

¹ICI members include 8,541 open-end investment companies (mutual funds), 653 closed-end investment companies, 143 exchange-traded funds, and 5 sponsors of unit investment trusts. Mutual fund members of the ICI have total assets of approximately \$7.838 trillion (representing more than 95 percent of all assets of US mutual funds); these funds serve approximately 87.7 million shareholders in more than 51.2 million households.

²See *Chamber of Commerce v. SEC*, No. 04-1300 (D.C. Cir. June 21, 2005).

³In recent Congressional testimony, the Institute's President, Paul Stevens, discussed the importance of such cost-benefit analysis to the effectiveness of the Commission's regulatory program. See Statement of Paul Schott Stevens, President, Investment Company Institute, before the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, Committee on Financial Services, United States House of Representatives, on "[Mutual Funds: A Review of the Regulatory Landscape](#)" (May 10, 2005), at 14-19.

⁴Under Section 16(a) of the Investment Company Act of 1940, vacancies on the board of directors may be filled without a shareholder vote if immediately after filling the vacancy, at least two-thirds of the directors have been elected by shareholders. In the event that at any time less than a majority of the directors are elected by shareholders, a shareholder meeting to elect directors must be held within 60 days, absent a Commission order extending that period.