Fund Democracy
The Mutual Fund Shareholder's Advocate

CFA Consumer Federation of America

February 18, 2004

To the Editor:

The purpose of this letter is to correct certain statements in Edward C. Johnson's Wall Street Journal editorial of February 17, 2004, in which he argues that mutual fund shareholders would be harmed if fund chairmen were required to be independent of the fund manager.

Mr. Johnson pretends to concede that he has an interest in this issue, but then proceeds to distort the true nature of that interest. For example, Mr. Johnson boasts that "my family and I have made considerable investments in these funds for over half a century," while modestly describing himself as the "part owner of the management company that invests [the Fidelity] funds' assets." The "considerable investments" are in fact a tiny fraction – less than 1% I would venture – of the value of his family's interest in the management company, estimates of which range from $10 to $12 billion.

In his attempt to pass himself off as just a fellow fund shareholder, Mr. Johnson also neglects to mention that his management company makes money from fees paid by the Fidelity funds. Every dollar in fees that goes into the Johnson family coffers is one dollar less in the pockets of fund shareholders. As the chairman of the Fidelity funds, Mr. Johnson negotiates this fee with himself. This is his "interest" in the issue, and it is the reason that under the law he is not an independent director.

Mr. Johnson asserts that, "[f]ar from constituting a conflict, these dual roles mean that my personal, professional and financial interests are directly aligned with those of Fidelity shareholders." This is simply false. The Fidelity funds have an interest in obtaining the services of Mr. Johnson's company at the lowest possible fee, and Mr. Johnson has an interest is receiving the highest possible fee.[1] As long as there have been buyers and sellers, this has been a conflict, and as long as Mr. Johnson is the chairman of the Fidelity funds, he will continue to sit on both sides of the table.

This conflict is not just about fees. The ever-expanding mutual fund scandal demonstrates a systemic failure of oversight by fund boards to detect and prevent misconduct by fund managers. Granted, there are instances in which an independent fund chairman has failed to protect shareholders, but does Mr. Johnson honestly believe a non-independent fund chairman would provide ***more*** protection? How likely is it that the fund manager's CEO would admit his own wrongdoing or betray his own firm to the fund's board?

Mr. Johnson reveals his true feelings about who really owns the Fidelity funds in suggesting that mandating an independent chairman would be "akin to requiring that every ship have two captains," and that an independent chairman would be someone "with 40 years experience making carbonated beverages, and who has just flown in for a

two-day board meeting." When the independent chairman requirement becomes law, the ship will have one captain – the independent chairman. Since it appears that Mr. Johnson plans to continue as a captain of the Fidelity funds even after he has been removed as chairman, and to install an independent chairman who has no relevant experience and a limited sense of commitment, the Fidelity funds may indeed have two captains, but this would violate the letter and spirit of the law.

The problem is not having a ship with two captains, but allowing Mr. Johnson to act as the captain of two ships. As captain of the management company ship, he owes a primary fiduciary duty to the shareholders of that company. In contrast, the captain of the Fidelity funds ship should owe his primary and exclusive fiduciary duty to the shareholders of those funds. These roles are in conflict. Mutual funds need one captain whose allegiance is to the fund and its shareholders; not a captain whose primary allegiance lies with the management company he is responsible for overseeing.

Finally, Mr. Johnson states that "the government's argument that independents are the silver bullet to prevent abuses just isn't supported by the facts." We are not aware of anyone in government, or in any other organization, for that matter, who has claimed or even suggested that an independent chairman is a "silver bullet." It is not and -- as Mr. Johnson knows full well -- is not intended to be a silver bullet. Nonetheless, a good idea that will improve fund governance should not be rejected simply because it will not perfect fund governance.

Contrary to Mr. Johnson's assertions, he and non-independent chairmen like him want to continue to captain someone else's ship – the mutual fund – because that puts them in the best position to benefit their own ship – the management company. If Mr. Johnson's jaded arguments reflect the way that he presents matters to the board of the Fidelity funds, then we can hardly imagine a better argument for requiring that the chairman of that board be independent.

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[1] "Investment advisers to mutual funds are generally organized as corporations, which have their own shareholders. These shareholders may have an interest in the mutual fund that is quite different from the interests of the fund's shareholders. ***For example, while fund shareholders ordinarily prefer lower fees (to achieve greater returns), shareholders of the fund's investment adviser might want to maximize profits through higher fees.*** And while fund shareholders might prefer that advisers use brokers that charge the lowest possible commissions, advisers might prefer to use brokers that are affiliates of the adviser. These types of conflicts (and others) resulted in the pervasive

abuses that led Congress in 1940 to enact legislation regulating the activities of mutual funds." Role of Independent Directors of Investment Companies, Investment Company Act Rel. No. 24082, at Part I (Oct. 14, 1999) (emphasis added).