

**Fund Democracy, Inc.
Consumer Federation of America
Consumer Action
AARP
Consumers Union**

April 18, 2006

BY ELECTRONIC AND U.S. MAIL

The Honorable Christopher Cox
Chairman
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-9303

Dear Chairman Cox:

We are writing on behalf of Fund Democracy, the Consumer Federation of America, Consumer Action, AARP, and Consumers Union to express our continued strong support for the independent chairman and 75 percent independent board requirements for mutual funds. We view these as among the most important reforms adopted by the Commission in response to the recent mutual fund trading and sales abuse scandals, and we would view any retreat from these requirements as an unwarranted weakening of essential protections for mutual fund shareholders. We therefore urge the Commission to take advantage of the mechanism the court has provided to reaffirm these rules with a minimum of disruption by promptly seeking public comment on the cost of implementation.

Nothing in the recent court decision undermines the basis for the Commission's action. On the contrary, the reasoning behind the Commission's action is unassailable. Recent market timing, late trading, breakpoint, and sales abuse scandals have clearly demonstrated that the independence and effectiveness of mutual fund boards needs to be strengthened to protect the interests of America's roughly 91 million mutual fund shareholders. In adopting the rule, the Commission specifically found these scandals resulted from "a serious breakdown in management controls" that demonstrated a need to strengthen fund governance. Indeed, the Commission found, after it adopted the governance requirements, that "the level of wrongdoing, and the corresponding investor losses, were in fact significantly greater than was known at the time." The Commission also noted the fund "adviser's monopoly over information about the fund and its frequent ability to control the fund's agenda" militated for enhancing the independence and effectiveness of fund directors.

No new evidence has arisen to undermine the Commission's conclusion that the independent chairman and 75 percent independent board rules are necessary to ensure that fund boards can operate effectively as a check on fund managers' conflicts of interest. These two requirements apply in the context of rules that exempt funds and fund managers from certain requirements imposed by Congress to protect investors. The Commission has correctly found that the continued viability of these exemptions necessitates stronger and more independent oversight by fund boards. Indeed, a failure to adopt these requirements would remove conditions of these exemptive rules that the Commission has expressly found necessary for their continuation and thereby call into question whether those rules should continue to have effect.

We also agree with the Commission's position, taken in its response to the first remand of this rulemaking, that the benefits of these requirements greatly exceed even the highest estimates of the costs of compliance. The Commission found that, "[w]hether the two conditions are viewed separately or together, even at the high end of the ranges, the costs of compliance are minimal." Again, nothing has changed to affect the Commission's conclusion in this respect. In fact, a recent survey by the Mutual Fund Directors Forum indicated that the actual costs of compliance were even lower than the estimates relied upon by the Commission and that the requirements were "likely to have a negligible impact on a fund's operating costs."¹ The MFDF also found that "[c]osts per fund will be even less significant for those funds which are part of a fund family where the costs can be allocated across all of the funds in the complex."

In order to ensure it has a sound body of evidence on which to base its decision, it is essential that, in its request for further comments, the Commission ensures that cost estimates submitted by fund companies accurately reflect the true costs of complying with these requirements and only these requirements. As noted by the Court, many funds have come into compliance with the requirements since the rules were proposed, and their experience will provide empirical evidence of actual compliance costs. We are concerned, however, that some firms may exaggerate these costs² or include the costs of complying with other rules. For example, the new requirement for a chief compliance officer and other new rules are likely to have triggered training and legal expenses incurred around the same time as the costs of transitioning to an independent chairman or 75 percent independent board. The Commission should require that any training or legal expenses incurred in connection with these two requirements be specifically identified.

In summary, the independent chairman and 75 percent independent board requirements reflect settled Commission positions that were well-vetted during the notice and comment period. Nothing in the Court's decision changes the basis of the Commission's findings or even suggests that the Commission should revisit its original

¹ Mutual Fund Directors Forum, *Cost Implications of an Independent Chair and a 75 Percent Independent Board at 1* (2005) at <http://www.mfdf.com/UserFiles/File/ReportofSurvey.pdf>.

² For example, one commenter asserted that it would hire three new independent directors rather than have one or more conflicted directors resign from the board.

justification for the requirements. In fact, the Court expressly stated that the Commission's cost estimates may well be accurate (if anything, they are too high), and it withheld final judgment for 90 days in order to prevent the disruption that would be caused by vacating the requirements only to have them reinstated once the Commission had again confirmed that the benefits of the rule outweigh its costs.

We strongly encourage the Commission to act promptly to obtain comments on the costs of the requirements in order to minimize the disruption caused by recent litigation. The independent governance rules are a necessary step to protect investors and promote confidence in our markets. Any delay in acting to finalize the rules, especially in light of the Commission's strong commitment to and investment in their adoption, will undermine confidence in the integrity of our markets and the independence of the Commission's own rulemaking process.

We appreciate your consideration of our comments.

Respectfully submitted,

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