IDC Independent Directors Council
Promoting Excellence in Fund Governance

ICI Supports Efforts to Reinforce Fund Director Independence, March 2004

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Letter Endorses Many SEC Governance Initiatives, But Suggests Independent Chair Requirement Unlikely to Produce Desired Benefits

Washington, DC, March 10, 2004 - The Investment Company Institute today submitted its comments on SEC proposals to enhance mutual fund governance by their boards of directors. Institute President Matthew Fink said, “Like the SEC, the ICI believes very strongly that mutual fund directors have played a crucial role in safeguarding shareholder interests. Indeed, the SEC’s confidence in the ability of thousands of conscientious, independent and committed mutual fund directors to serve and protect fund shareholders faithfully and effectively is clearly the foundation of the SEC proposals we commented on today.”

With respect to the SEC’s proposals to enhance fund governance, Institute General Counsel Craig Tyle said, “the ICI supports all of the SEC’s objectives, and many of the specific reforms designed to achieve those objectives.”

Requiring a Supermajority of Independent Directors

The ICI’s letter supports the SEC proposal to require a supermajority of independent mutual fund directors. The letter says the requirement “helps to assure that independent directors control the voting process, particularly on matters involving potential conflicts of interest.”

While the ICI firmly supports a supermajority requirement, the letter notes that the proposed seventy-five percent standard will produce “increased disruption and costs.” The letter notes that most fund boards already have supermajorities in place. The move to supermajorities followed a resolution by the ICI’s Board of Governors in 1999 that recommended a two-thirds supermajority standard as one of a series of mutual fund governance best practices.

The ICI letter says requiring “a change from the current practice of a two-thirds supermajority to a seventy-five percent requirement would mean that at least half of all fund boards would have to change their current composition,” a change unlikely to produce “any foreseeable benefit for shareholders.” The letter points out that “[f]unds would be required to effect this change at a time when they could better channel those efforts to implement other new requirements that would have more direct benefits to investors.” The letter recommends that the Commission adopt a requirement that independent directors constitute at least two-thirds of fund boards.

Requiring All Mutual Funds To Have An Independent Chair

Institute General Counsel Tyle said that overall, “the ICI letter reflects only one real policy difference between the industry and the SEC. It is whether current and future fund investors will benefit from an inflexible regulatory mandate that requires every mutual fund board to have an independent chair. Our best judgment is that the hoped-for benefits are highly unlikely to be realized. Most fund boards already consist of a supermajority of independent directors who have the power and authority to elect an independent chairman if they see fit. We believe there are better alternatives, which we support in the letter. One is to require that the board chair be elected annually by a majority of the board as a whole, and a majority of the independent directors. Another option would be to require funds that do not have an independent chair to appoint a lead independent director. ”

The ICI’s letter says “We believe that the selection of an appropriate person to serve as chairman of the board rightfully is, and should continue to be, a decision made by the directors themselves.” The ICI recognizes that “some fund boards may find that [an independent chair] structure works well for them.” But the letter contends that the mandatory nature of “[t]he Commission’s proposal … seems completely at odds with an overall regulatory scheme that relies on fund directors to make sound judgments in the vigilant exercise of their oversight responsibilities.”

Other Proposed Governance Reforms

The ICI’s letter also expressed support for several other SEC proposed governance reforms.

- Requiring mutual fund boards to conduct mandatory, annual self-assessments
- Requiring mutual fund independent directors to meet separately each quarter
- Expressly authorizing independent directors to retain experts or hire staff
- Requiring the retention of records relating to the approval of advisory contracts

The ICI noted that “[a]lthough many fund boards voluntarily adopted [the ICI Board’s 1999] recommendations, we believe that more of the best practice recommendations now should be codified as part of the Commission’s regulatory scheme to improve the structure and processes of all fund boards and promote investor confidence in the fund governance system.”

ICI President Matthew Fink noted that “while we don’t agree that every proposed change will achieve the benefits that are hoped for, the ICI believes very strongly that the SEC’s extraordinary package of mutual fund reform proposals, including those addressing fund governance, will ultimately greatly strengthen mutual funds and make them better guardians of Americans’ long-term investments.”
