



September 30, 2008

Ms. Florence E. Harmon
Acting Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Commission Guidance Regarding the Duties and Responsibilities of Investment Company Boards of Directors with Respect to Investment Adviser Portfolio Trading Practices; File No. S7-22-08

Dear Ms. Harmon:

The Independent Directors Council¹ is pleased to provide comments on the proposed guidance to fund boards to assist them in fulfilling their oversight responsibilities with respect to the trading of portfolio securities.² IDC commends the Commission for responding to requests from fund directors for guidance in this important area of their responsibilities.

Fund directors take very seriously their duties under federal and state law, which the Proposed Guidance outlines.³ They work diligently in overseeing a fund adviser's trading practices, including satisfaction of the adviser's best execution obligations and its use of fund brokerage commissions. They focus particularly on monitoring potential conflicts of interest in this area, with the overriding goal of protecting the interests of fund shareholders.

The fact that fund directors sought Commission guidance and, as the Commission noted, seek continued education in this rapidly evolving area, demonstrates the vigilance with which fund directors approach their responsibilities on behalf of shareholders. IDC, in furtherance of

¹ IDC serves the fund independent director community by advancing the education, interaction, communication, and policy positions of fund independent directors. IDC's activities are led by a Governing Council of independent directors of Investment Company Institute member funds. ICI is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds, and unit investment trusts. Members of ICI manage total assets of \$12.14 trillion and serve almost 90 million shareholders. The views expressed by IDC in this letter do not purport to reflect the views of all fund independent directors.

² See Commission Guidance Regarding the Duties and Responsibilities of Investment Company Boards of Directors with Respect to Investment Adviser Portfolio Trading Practices, SEC Release Nos. 34-58264; IC-28345; and IA-2763 (July 30, 2008) ("Proposed Guidance").

³ The Proposed Guidance's citation to the district court decision in *Strougo v. Scudder, Stevens and Clark, Inc.*, 964 F. Supp. 783, 798 (S.D.N.Y. 1997) in n. 25 should be corrected to reflect the Second Circuit's later holding that "implied private rights of action do not exist" under Section 36(a) of the Investment Company Act of 1940 ("1940 Act"). See *Bellikoff v. Eaton Vance Corp.*, 481 F.3d 110, 117 (2d Cir. 2007).

its mission to advance the education of fund directors, will continue to provide educational opportunities relating to oversight of portfolio trading practices. Last year, IDC hosted a day-long workshop devoted to the subject of capital markets and trading considerations, and we plan to establish a task force to study this area and develop a report that will provide educational information about trading practices and practical guidance to fund directors.

IDC's specific comments on the Commission's proposal are discussed below.

Proposed Guidance Regarding Oversight of Trading Practices

IDC supports the Commission's objective of providing guidance that is relevant, useful, and beneficial to fund directors. The Commission's expressed intent is to assist fund directors and not to impose any new or additional requirements. To ensure that the guidance meets the Commission's goal, IDC urges the Commission to address and clarify the following matters.

First, IDC recommends that the final guidance confirm that the board's role is to provide oversight and not to make specific determinations about specific trading practices or soft dollar services. We suggest that the final guidance emphasize that boards may exercise oversight in a number of ways, and the guidance is not designed to require a fund board to make specific formal determinations or findings concerning trading practices or the use of soft dollars.

Second, IDC urges the Commission to avoid the development of mandatory "checklists" for fund directors. The Proposed Guidance helpfully identifies, among other things:

- data fund boards might consider seeking, and related matters they may wish to discuss with the adviser, to assist them in evaluating the adviser's procedures regarding best execution obligations;
- ways in which conflicts of interest may arise when advisers use fund assets in soft dollar programs that a fund board may evaluate;
- information boards might request from the adviser to assist them in understanding the adviser's policies and procedures regarding the use of fund brokerage commissions; and
- information relating to the adviser's use of fund brokerage, including soft dollar arrangements, that boards may request in connection with the advisory contract review process.

The Commission should make clear in its final guidance that these are *suggested* lists of data, information, factors, or discussion items for fund boards to consider and *not* mandatory "checklists." The Commission also should make clear that boards may consider the totality of circumstances in evaluating whether the fund's adviser is fulfilling its fiduciary obligations and is acting in the best interest of the fund, and are not bound by any particular listed factor or piece

of data or information. Moreover, the Commission should clarify that each board may determine for itself the frequency with which it will evaluate this data and information.

As the Commission noted, one size does not fit all in this context, and market conditions and trading practices are rapidly evolving. It is imperative that fund directors have the flexibility to approach their oversight responsibilities in the context of the specific circumstances of the funds they oversee. While the Commission acknowledged in one part of the Proposed Guidance that not all funds would require the evaluation of each of the listed factors by their boards, and that “[d]ifferent factors may be appropriate for different funds, depending on a fund’s investment objective, trading practices, and personnel,”⁴ IDC urges the Commission to highlight and emphasize this point in its final guidance and with respect to all suggested data and information to request and matters to discuss. Guidance that provides useful suggestions, rather than mandatory checklists, would be consistent with the objective of the Division of Investment Management’s Director Outreach Initiative to rationalize directors’ regulatory responsibilities so that they may provide appropriate oversight without being required to engage in routine reviews of specific matters that may not necessarily be pertinent to their fund.

History has demonstrated that the Commission’s practice of listing suggested factors to be considered by fund boards and others tends to be interpreted as creating a list of required factors. The now-outdated nine factors included in the rule 12b-1 adopting release provide a perfect example: despite the Commission’s characterization of them as factors that “may provide helpful guidance to directors” when considering rule 12b-1 plans,⁵ they became a standard checklist that, over time, was not relevant, useful, or beneficial for fund directors. Moreover, fund directors share the concern expressed at the open meeting that the Commission’s own examination staff might come to view the specified matters as mandatory checklists and approach their inspections of funds, including board actions, accordingly. Other parties seeking to challenge the conduct of a fund board may also hold these suggested factors out as mandatory. For these reasons, IDC urges the Commission to clarify in its final guidance that the Proposed Guidance’s lists should not be regarded as mandatory checklists.

Third, IDC is concerned that the language in the Proposed Guidance with respect to the regulatory framework for board oversight of soft dollars may confuse the interplay between Section 28(e) of the Securities Exchange Act of 1934, the 1940 Act, including Section 15(c) of the 1940 Act, and state fiduciary law. For example, the Proposed Guidance suggests that fund boards should evaluate whether “the fund’s brokerage commissions could be used differently so as to provide greater benefits to the fund.”⁶ We are not sure what this means and are concerned it could be interpreted as establishing a new standard.

⁴ See Proposed Guidance, *supra* n. 2, at 19.

⁵ See Bearing of Distribution Expenses by Mutual Funds, SEC Release No. IC-11414 (Oct. 28, 1980).

⁶ Proposed Guidance, *supra* n. 2, at 32.

Section 28(e) permits an adviser to consider the value of soft dollar benefits to all accounts for which it exercises investment discretion, and not just the fund whose trades generated the commissions. Thus, research and brokerage services purchased with fund brokerage commissions that may benefit another advisory client are in no way inappropriate.

The 1940 Act should not be interpreted as restricting the statutory safe harbor, nor should the fund board's fiduciary duty be interpreted as overriding it. As the SEC staff observed in its 1998 study of soft dollar practices, the value of soft dollar services should be addressed in the context of reviewing the adviser's management contract:

Section 15(c) of the Investment Company Act requires the board of directors of a registered investment company to request and review, and the fund's adviser to supply, such information as may reasonably be necessary for the fund's board to evaluate the terms of the advisory contract between the adviser and the investment company. Research and other services purchased by the adviser with the fund's brokerage bear upon the reasonableness of the advisory fee because the research and other services would otherwise have to be created by the adviser itself or be purchased with its own money. Therefore, investment company advisers that have soft dollar arrangements must provide their funds' boards with information regarding their soft dollar practices.⁷

The final guidance should confirm that a fund board may use its discretion to determine whether the fund is benefiting from the soft dollar services acquired by the adviser and the fact that other clients, including other mutual funds, are receiving benefits should not lead to the conclusion that "services are *inappropriately* benefiting another of the adviser's clients at the fund's expense" (emphasis supplied).⁸

Request for Comment Regarding Proposed Additional Disclosure

The Commission requests comment on whether it should propose additional disclosure to fund investors of the information it is suggesting that fund boards should consider. While IDC supports disclosure of useful and relevant cost information to fund investors, we do not believe that additional disclosure to fund investors is warranted at this time. The disclosure regarding brokerage practices, including the use of soft dollars, that currently is required in fund registration statements,⁹ combined with fund board oversight of portfolio trading, which includes evaluation of soft dollar arrangements, provide a sound and balanced regulatory approach. We

⁷ The Office of Compliance, Inspections and Examinations, U.S. Securities & Exchange Commission, *Inspection Report on the Soft Dollar Practices of Broker-Dealers, Investment Advisers and Mutual Funds* (September 22, 1998). This is consistent with guidance that the Commission provided as far back as 1986.

⁸ See Proposed Guidance, *supra* n. 2, at 32.

⁹ See Item 16, Form N-1A and Item 22, Form N-2 under the 1940 Act.

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believe that there are a number of other, more pressing matters that the Commission and its staff may wish to pursue at this time.

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If you have any questions about our comments, please contact Amy B.R. Lancellotta, Managing Director, Independent Directors Council, at 202-326-5824.

Sincerely,



Robert W. Uek
Chair, IDC Governing Council

cc: The Honorable Christopher Cox, Chairman
The Honorable Kathleen L. Casey
The Honorable Elisse B. Walter
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