

American Federation of Labor and Congress of Industrial Organizations



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August 21, 2006

Nancy M. Morris
Secretary, Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Ms. Morris:

I am writing on behalf of the American Federation of Labor and Congress of Industrial Organizations ("AFL-CIO") to express our continued strong support for the independent board chair and 75 percent independent board requirements for mutual funds. These rules were among the most important reforms adopted by the SEC in the wake of the mutual fund trading and sales abuse scandals. We would view any retreat from these requirements as an unwarranted weakening of crucial protections for fund shareholders.

In its June 13, 2006 release, the Commission asked for comment on the costs associated with the independent chair and 75 percent independent board requirements. The AFL-CIO believes strongly that these two independence conditions will have negligible incremental costs on funds and their shareholders. Moreover, any incremental costs associated with more independent mutual fund boards will likely be offset by reduced mutual fund operating expenses. Requiring a supermajority of independent directors and independent board chairs will enhance the ability of boards to negotiate lower management fees with fund investment advisors.

The labor movement's interest in mutual fund independence stems from the fact that union members are also investors. Union members participate in benefit plans with over \$5 trillion in assets. Union-sponsored pension plans hold approximately \$400 billion in assets, and union members also participate in the capital markets as individual investors. Mutual funds increasingly make up the primary or secondary retirement savings vehicle for tens of millions of working Americans through 401(k) and IRA accounts.

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Greater Mutual Fund Board Independence Will Reduce Mutual Fund Expenses

Mutual fund expense ratios have a dramatic impact on investor return, including the retirement savings of working families that are invested in mutual funds. Over time, these recurring expenses can devour a substantial percentage of mutual fund investor returns. For example, if a mutual fund portfolio earns 10 percent a year over 20 years, a 1.5 percent annual operating expense will reduce total investment returns by over 25 percent in fees and forgone earnings. And unlike past performance, mutual fund expenses are a reliable predictor of mutual fund returns.

Unfortunately, as mutual fund assets have grown, economies of scale have not resulted in lower mutual fund fees for investors. According to a report by the Commission's Division of Investment Management, the mutual fund industry's average weighted expense ratio increased from 0.73 percent in 1979 to 0.94 percent in 1999 (Report on Mutual Fund Fees and Expenses, December 2000). This report concluded that "the current regulatory framework would be enhanced by independent directors who more actively monitor fund fees and expenses."¹

Ineffective mutual fund boards are responsible for these escalating mutual fund fees. A mutual fund board is responsible for hiring the fund's investment advisor and negotiating operating expenses. Traditionally, mutual fund boards have been comprised of a majority of directors who also are executives of the mutual fund's investment advisor. These directors are hopelessly conflicted, as they owe a fiduciary duty to the shareholders of the mutual fund's investment advisor. This conflict of interest is most apparent in the negotiation of management fees between the mutual fund and investment advisor.

The primary purpose of a mutual fund board is to protect investor interests by providing independent oversight of a mutual fund's investment advisor. The chair of the board, who sets agendas, priorities and procedures, plays a critical role in shaping the work of the board. Accordingly, we believe that having an independent director serve as board chair is essential to ensuring the objectivity and effectiveness of the board. Similarly, requiring a supermajority of independent directors will strengthen the ability of mutual fund boards to negotiate operating fees on an arms-length basis.

The Cost Of Compliance With The Rules Will Be Lower Than The SEC's Estimates

A recent survey by the Mutual Fund Directors Forum indicated that the actual costs of compliance with the rule were even lower than estimates relied on by the Commission and that the requirements were "likely to have a negligible impact on a

¹ <http://www.sec.gov/news/studies/feestudy.htm>

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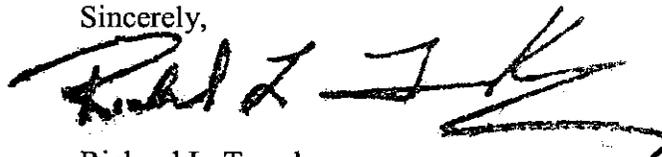
fund's operating costs."² The survey found that the costs incurred by members already operating with the rules were at the low end of the range of estimates provided by the Commission. Further, it determined that any additional costs will be substantially less than one percent of the aggregate advisory fees incurred by the fund (a single stand-alone fund), or the family of funds in the complex.

The survey concluded that costs per fund will be even less significant for those funds which are part of a fund family, where costs can be allocated across all of the funds, and costs related to proxy solicitation and recruiting independent directors will be one time costs. Moreover, a large number of mutual funds already comply with the proposed rules and will not incur any additional costs. According to the *Wall Street Journal*, the SEC estimates 60% of mutual fund boards are at least three-quarters independent.³ Also, as of year-end 2004, 43% of mutual funds had an independent board chair according to the Investment Company Institute.

We are concerned that some mutual fund investment advisors may be exaggerating the costs that will be incurred from the proposed rules. For example, one commenter asserted that it would hire three new independent directors rather than have one or more conflicted directors resign. Opponents of the proposed rule may be including the costs of complying with other rules such as the new requirement for a chief compliance officer. The Commission should require that the compliance costs of any other rules be separately considered.

The independent board chair and 75 percent independent board requirements reflect settled Commission precedent that was well vetted during prior notice and comment periods. Nothing in the Court's decision changes the basis of the SEC's findings. In fact, the Court expressly stated that the Commission's costs estimates may well be accurate. We strongly encourage the Commission to preserve these rules in their current form. If we can be of further assistance, please contact Damon Silvers at 202-637-3953.

Sincerely,

A handwritten signature in black ink, appearing to read "Richard L. Trumka", with a long horizontal flourish extending to the right.

Richard L. Trumka

RLT/mg

² 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>.

³ "Activism by Independent Directors Leads to Wincing, Lower Fees," *Wall Street Journal*, June 5, 2006.