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January 14, 2010

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Facilitating Shareholder Director Nominations (File No. S7-10-09)

Dear Ms. Murphy:

The Independent Directors Council[1] appreciates the opportunity to provide its views on the Securities and Exchange Commission's proposal to facilitate shareholders' ability to nominate company directors.[2] During the initial comment period, several commenters explained how the application of the proposal to investment companies would be potentially disruptive and costly to fund operations.[3] IDC writes to reinforce this critical point from the perspective of independent directors.

While IDC is not opposed to the concept of enhancing shareholder access in the investment company context, we believe that the proposal, in its current form, could significantly impede, rather than enhance, the efficient and effective governance of funds. Although following the initial comment period Commission staff undertook further analyses of certain elements of the proposal, disappointingly it did not address the significant issues raised by commenters regarding the application

[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 $11.62 trillion and serve almost 90 million shareholders, and there are approximately 2,000 independent directors of ICI member funds. The views expressed by IDC in this letter do not purport to reflect the views of all fund independent directors.

[2] *See* SEC Release Nos. 33-9046; 34-60089; IC-28765 (June 10, 2009). The Commission re-opened the comment period for the proposal to allow interested persons to comment on a variety of data and analyses submitted or added to the public comment file at or after the close of the initial comment period, including the Commission staff's updated analysis of share ownership and holding period patterns. *See* SEC Release Nos. 33-9086; 34-61161; IC-29069 (December 14, 2009).

[3] *See* Attachment for list of comment letters.

of the proposal to investment companies. Therefore, we strongly urge the Commission to exclude investment companies from the current proposal and, instead, undertake a thorough consideration of the threshold issue of whether it should apply to investment companies. If the Commission determines that it should, then the Commission should develop a more appropriate proposal tailored for investment companies.[4]

Role of Fund Independent Directors

As several commenters noted, the proposal does not account for the fundamental differences in governance models between public operating companies and investment companies. In addition to the unitary and cluster board models that distinguish fund boards from operating company boards (discussed below), it is important to keep in mind the overall regulatory structure for investment companies under the Investment Company Act of 1940 (1940 Act), the significant shareholder protections it provides, and the critical role of fund independent directors under its framework.

The 1940 Act and the rules under it impose specific responsibilities on the independent directors of the board (for example, a majority of the independent directors must approve the contract with the fund's adviser).[5] As the Supreme Court has recognized, the 1940 Act was designed to place independent directors in the role of "independent watchdogs," and Congress entrusted them with "the primary responsibility" for looking after the interests of fund shareholders.[6]

Fund boards are robustly independent. Each independent director must satisfy stringent independence requirements.[7] The Commission's fund governance standards require, among other things, that independent directors—not the fund's adviser or interested directors—select and nominate other independent directors.[8] And while the 1940 Act requires that at least 40 percent of directors be

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[4] The Commission staff's most recent analysis, which covers both ownership levels and holding periods, reflects their effect on certain exchange-listed issuers, *not* on mutual funds or ETFs. It is telling that the staff memorandum discussing the data highlights several limitations and qualifications but never specifically mentions the exclusion of mutual funds or ETFs. *See* Memorandum to File S7-10-09 from Jennifer Marietta-Westberg and Joshua White, Division of Risk, Strategy, and Financial Innovation, Regarding Share Ownership and Holding Period Patterns in 13F Data, dated November 24, 2009.

[5] *See* Section 15(c) of the 1940 Act.

[6] *Burks v. Lasker*, 441 U.S. 471, 484-85 (1979).

[7] *See* Section 2(a)(19) of the 1940 Act.

[8] Rule 0-1(a)(7) under the 1940 Act. While the Commission mandated this and other requirements only as a condition of reliance on certain exemptive rules, substantially all funds rely on one or more of these rules, and thus the requirements apply to virtually all funds.

independent of the adviser,[9] in practice, independent directors hold an overwhelming majority (75 percent) of board seats in nearly 90 percent of fund complexes.[10]

Against this backdrop of shareholder protections, we question the policy basis for extending the proposed requirements to investment companies. And, indeed, the Commission has not presented empirical data or other information to explain a basis for doing so.

Governance Structures for Investment Companies

Extending the proposal to investment companies would be problematic because of the unique governance models they employ. The boards of most funds are organized according to one of two models—a "unitary" board consisting of one group of directors who serve on the board of every fund in the complex, or "cluster" boards consisting of two or more separate boards of directors within the complex, that each oversees a different group of funds.[11]

The prevalence of these models is no historical accident: they offer a logical and practical approach to governance that is derived from the unique features of funds. In 2005, an IDC task force of independent directors considered director oversight of multiple funds and endorsed the unitary and cluster board models as "consistent with good governance." The task force report, *Director Oversight of Multiple Funds*, explained:

> Most of the investment companies (and their portfolios) within the same family or complex are created by the same fund management firm and have a common investment adviser, principal underwriter and administrator. They commonly receive necessary services (including, for example, portfolio management, shareholder recordkeeping, custody of fund securities, distribution of fund shares, legal counsel, and auditing) from the same entities. Investment company complexes are organized around these common operating features and are designed to take advantage of the efficiencies inherent in single service providers. . . . It is unnecessary (and undesirable in terms of cost and administrative burdens) to require each investment company to have a separate board performing similar if not identical functions.[12]

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[9] Section 10(a) of the 1940 Act.

[10] Investment Company Institute and Independent Directors Council, *Overview of Fund Governance Practices, 1994-2008* (available at http://www.idc.org/pdf/pub_09_fund_governance.pdf) ("Fund Governance Practices").

[11] A recent ICI/IDC survey of fund complexes (representing 93 percent of the industry's total net assets) showed that 83 percent of the complexes had a unitary board structure and 17 percent had a cluster board structure. See Fund Governance Practices, supra n. 10, at 5.

[12] Independent Directors Council Task Force Report *Director Oversight of Multiple Funds* (May 2005) (available at http://www.idc.org/pdf/ppr_idc_multiple_funds.pdf).

The task force report cited the many advantages of the unitary and cluster board models (many of which were also noted by commenters on the Commission's current proposal), including:

- *Common regulatory structure.* The detailed regulatory scheme under the 1940 Act, which governs all investment companies, creates a common set of issues for fund directors to consider and duties to discharge with respect to all of the funds they oversee. For example, fund directors are required to, among other things, establish standards for valuation of portfolio securities; review the liquidity of certain types of portfolio securities; and oversee fund brokerage, soft dollar, and trade allocation procedures. The standards that govern directors' determinations in these areas apply to all funds in a complex.

- *Common personnel and service providers.* Because all funds within the same complex generally are served by common personnel and utilize common service providers, the manner in which these issues are addressed tends not to vary much from fund to fund. Policies and practices and contractual arrangements within a fund complex tend to be fairly uniform. Examples of these include shareholder services; compliance monitoring procedures (including funds' codes of ethics); proxy voting policies; and fair valuation policies and procedures. It is generally far more efficient to have a single board, or a few cluster boards, review these common policies and procedures and oversee common arrangements and easier to implement any changes on a complex-wide basis than in a piecemeal fashion (which could occur if different boards for different funds were to come to different conclusions).

- *Complex-wide oversight mechanisms.* The mechanisms that boards use to assist in their oversight of funds and fund service providers generally apply on a complex-wide basis. These include board oversight of compliance, risk, and the audit function. The compliance program rule, in particular, provides the board with a powerful tool to exercise its oversight responsibilities and envisions a unified compliance program for the fund complex[13] that would be more efficiently and effectively overseen by a unitary board or cluster boards.

- *Enhanced board influence.* The practice of having a single board oversee all of the funds within a complex—or within a cluster of funds in the complex—enhances the board's knowledge and expertise, as well as its authority and influence. As a result, the board's effectiveness in serving the interests of fund shareholders is enhanced.

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[13] In the Commission's adopting release for Rule 38a-1 under the 1940 Act, it noted that the appointment of a chief compliance officer was intended to replace practices that "balkanize responsibility for fund compliance." *See* Compliance Programs of Investment Companies and Investment Advisers, SEC Release Nos. IA-2204; IC-26299 (Dec. 17, 2003).

IDC agrees that unitary and cluster board structures enhance independent directors' effectiveness on behalf of fund shareholders. We are, therefore, very concerned that the extension of the proposal's requirements to investment companies could potentially eliminate these structures for some complexes and impede, rather than enhance, fund governance, as discussed below.

Proposal's Potential Impact on Efficient and Effective Fund Governance

As other commenters have noted, the proposal, if applied to investment companies, would create the possibility for a complex to lose the unitary or cluster board model it had established if a shareholder of one of the registered funds in the complex or cluster were to nominate a director for that fund who is elected. In that circumstance, there would be one board overseeing all of the funds in the complex except the one with the new director (and, in a cluster board context, one board overseeing all of the funds in the cluster except the one with the new director).

The change in governance structure would cause the fund to incur additional costs and experience administrative difficulties. For example, arrangements would have to be made for the one director to leave during discussions that pertain only to other funds that he does not oversee (particulary when the discussions are of a highly confidential nature), and board materials would have to be customized for that director. Moreover, efficient processes for board reporting (such as providing aggregate data for all funds) and for applying one set of procedures for all funds, would be disrupted if the data had to be disaggregated to some extent and procedures tailored for a particular fund. Setting up procedures to deal with these issues would generate additional costs that ultimately would be borne by fund shareholders.

Over time, this situation could be exacerbated, with many different boards overseeing many different funds in the complex. And the benefits of the unitary and cluster board models discussed above would be diminished, if not eliminated, to the detriment of efficient and effective fund governance on behalf of fund shareholders.

* * *

We agree with ICI that the existing governance system that Congress and the Commission have thoughtfully crafted for investment companies has worked well for funds and their shareholders. We urge the Commission to not alter this system without first comprehensively considering the significant ramifications for funds and their shareholders, and only after such critical steps are taken, determining whether devising proxy access requirements relating to fund director nominations or the nominating process is appropriate. Because the current proposal does not do this, we recommend that it exclude investment companies from its application.

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

Sincerely,

Michael S. Scofield
Chair, IDC Governing Council

cc: The Honorable Mary L. Schapiro, Chairman
The Honorable Kathleen L. Casey, Commissioner
The Honorable Elisse B. Walter, Commissioner
The Honorable Luis A. Aguilar, Commissioner
The Honorable Troy A. Paredes, Commissioner

Andrew J. Donohue, Director
Susan Nash, Associate Director
Division of Investment Management

Meredith B. Cross, Director
Division of Corporation Finance

U.S. Securities and Exchange Commission

Attachment: Comment Letters

Letter from Abe M. Friedman, Managing Director, Barclays Global Investors, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission (August 14, 2009)

Letter from Paul Schott Stevens, President and Chief Executive Officer, Investment Company Institute, to Elizabeth Murphy, Secretary, U.S. Securities and Exchange Commission (August 17, 2009)

Letter from Anne T. Chapman, Vice President—Fund Business Management Group and Chad L. Norton, Vice President—Fund Business Management Group, Capital Research and Management Company, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission (August 17, 2009)

Letter from Donna F. Anderson, Vice President and Global Governance Analyst, and Darrell N. Braman, Vice President and Managing Counsel, T. Rowe Price Associates, Inc., to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission (August 17, 2009)

Letter from William M. Tartikoff, Senior Vice President and General Counsel, and Ivy Wafford Duke, Assistant Vice President and Deputy General Counsel, Calvert, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission (August 17, 2009)

Letter from Sullivan & Cromwell LLP to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission (August 17, 2009)

Letter from Heidi Stam, Managing Director and General Counsel, Vanguard, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission (August 18, 2009)

Letter from Jeffrey W. Rubin, Chair of the Committee on Federal Regulation of Securities of the Section of Business Law, American Bar Association, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission (August 31, 2009)