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January 3, 2013

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

Re: List of Rules to be Reviewed Pursuant to the Regulatory Flexibility Act; File No. S7-12-12

Dear Ms. Murphy:

The Independent Directors Council<sup>1</sup> appreciates the opportunity to comment on the rules being reviewed by the SEC pursuant to Section 610 of the Regulatory Flexibility Act.<sup>2</sup> On numerous occasions, IDC has offered its perspective on rules under the Investment Company Act of 1940 (the “1940 Act”) that impact fund directors and the modifications that could be made to help assure the effectiveness of fund boards.<sup>3</sup> Thus, IDC is commenting on those rules affecting fund directors that the SEC is reviewing at this time.

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<sup>1</sup> IDC serves the fund independent director community by advancing the education, communication, and policy positions of fund independent directors, and promoting public understanding of their role. 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 \$13.9 trillion and serve over 90 million shareholders, and there are approximately 1,900 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.

<sup>2</sup> See List of Rules to be Reviewed Pursuant to the Regulatory Flexibility Act, Release Nos. 33-9370; 34-68309; IA-3506; IC-30282 (December 4, 2012).

<sup>3</sup> See, e.g., Letter from Robert W. Uek, Chair, IDC Governing Council, to Andrew J. Donohue, Director, Division of Investment Management, Securities and Exchange Commission regarding Director Outreach Initiative (February 26, 2008), available at <http://www.idc.org/pdf/22275.pdf> (“Uek Letter”); Letter from Dorothy A. Berry, Chair, IDC Governing Council, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission regarding Retrospective Review of Existing Regulations (October 6, 2011), available at <http://www.sec.gov/comments/s7-36-11/s73611-48.pdf>.

A number of years ago, the SEC proposed<sup>4</sup> and adopted<sup>5</sup> amendments to ten exemptive rules under the 1940 Act to require that funds, in order to rely on those rules, comply with certain governance practices. At the same time, the SEC amended certain rules affecting the role of fund directors. The amendments sought to enhance the independence and effectiveness of boards. Three of the rules discussed below—Rules 2a19-3, 10e-1, and 32a-4—were adopted as part of this effort and should remain unchanged because they continue to help fund boards function effectively. The other rule discussed below, Rule 5b-3, is a technical rule about the treatment of repurchase agreements and should be amended to reflect a fund board's oversight role.

### *Rule 2a19-3*

Rule 2a19-3 exempts an individual from being disqualified as an independent director solely because he or she owns shares of an index fund that invests in securities issued by the investment adviser or underwriter of the fund, or their controlling persons. The independence standards under the 1940 Act and its rules are intended to exclude persons with affiliations or business interests that can impair their independence. In proposing Rule 2a19-3, the SEC cited Congress's directive to apply the independence standards "in a flexible manner" and adopt appropriate exemptions.<sup>6</sup> The SEC did just that by permitting an independent director to own shares of a fund whose investment objective is to replicate the performance of one or more broad-based securities indices. We believe the exemption continues to benefit shareholders, funds, and independent directors by helping to prevent qualified individuals from being unnecessarily disqualified from serving as independent directors. We therefore recommend that Rule 2a19-3 continue without change.

### *Rule 10e-1*

Rule 10e-1 suspends temporarily the board composition requirements regarding the percentage of "disinterested directors" contained in the 1940 Act and its rules if a fund fails to meet the requirements due to the death, disqualification, or bona fide resignation of a director. The rule suspends the board composition requirements for 90 days if the board can fill the director vacancy, or 150 days if a shareholder vote is required to fill the vacancy. When adopted, the rule increased the time frame of the suspension because it determined that the time provided by Section 10(e)—30 days if the board can fill the vacancy; 60 days if the vacancy must be filled by shareholder vote—was insufficient for most funds to select and nominate qualified independent director candidates and, if necessary, hold

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<sup>4</sup> See Proposed Rule: Role of Independent Directors of Investment Companies, Release Nos. 33-7754; 34-42007; IC-24082 (October 15, 1999) ("Proposing Release").

<sup>5</sup> See Final Rule: Role of Independent Directors of Investment Companies, Release Nos. 33-7932; 34-43786; IC-24816 (January 2, 2001) ("Adopting Release").

<sup>6</sup> See Proposing Release, *supra* n. 4 (citing H.R. Rep. No. 1382, 91st Cong., 2d Sess. 15 (1970)).

a shareholder meeting.<sup>7</sup> This relief helps the fund to not immediately face the severe consequences of losing the availability of the exemptive rules and should therefore remain unchanged.

#### *Rule 32a-4*

Rule 32a-4 exempts funds from the 1940 Act's requirement that shareholders vote on the selection of a fund's independent public accountant if the fund: establishes an audit committee composed solely of independent directors that oversees the fund's accounting and auditing processes; adopts an audit committee charter setting forth the committee's structure, duties, powers, and methods of operation, or sets out similar provisions in the fund's charter or bylaws; and maintains a copy of the audit committee charter. Shareholder ratification of a fund's independent auditor was a perfunctory process, with votes that were rarely contested,<sup>8</sup> whereas board audit committees are uniquely qualified, due to their interactions with and oversight of the fund's auditor, to assess the auditor's performance. Therefore, this exemption continues to benefit funds and their shareholders, fits squarely within the appropriate role of directors, and should remain unchanged.

#### *Rule 5b-3*

Rule 5b-3 allows funds to "look through" certain repurchase agreements for certain purposes of the 1940 Act so long as the obligation of the seller to repurchase the securities from the fund is "collateralized fully." The rule's definition of "collateralized fully" requires, among other things, that the fund's board or its delegate determine that collateral consisting entirely of unrated securities be of comparable quality to rated securities. Rule 5b-3 should be amended to relieve a fund's board of this responsibility because directors do not have the expertise to make the determination; rather, representatives of the fund's investment adviser are much more appropriately suited to assess the quality of the securities.

IDC has long made the case that the appropriate role of independent directors—and the role in which they are most effective—is to provide oversight and not to be involved in the day-to-day operations of a fund. In 2008, IDC submitted a letter to the SEC's Division of Investment Management making this point and identifying certain board functions, including the board determination required by Rule 5b-3, in which the role of fund directors should be examined.<sup>9</sup> In the letter we stated that, while the rule permits a delegate to make the determination, the rule should be amended to relieve the board of making the collateral determination because the finding falls within the rubric of fund operations.

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<sup>7</sup> See Adopting Release, *supra* n. 5.

<sup>8</sup> See Proposing Release, *supra* n. 4.

<sup>9</sup> See Uck Letter, *supra* n. 3.

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If you have any questions about our comments, please contact me at (202) 326-5824.

Sincerely,



Amy B.R. Lancellotta

Managing Director, IDC Governing Council

cc: The Honorable Elisse B. Walter  
The Honorable Luis A. Aguilar  
The Honorable Troy A. Paredes  
The Honorable Daniel M. Gallagher

Norm Champ, Director, Division of Investment Management