

**Concurring Views of Commissioner Roel C. Campos  
at Open Commission Meeting  
Commission Response to Remand by Court of Appeals**

Thank you Chairman Donaldson. I have a short statement to make about this action regarding our Agency's mutual fund governance rulemaking and the Response to the Remand by the Court.

I. American Mutual Fund Investors Have Been Under Attack.

Beginning about two years ago the American public and this Agency became suddenly aware that American mutual fund investors were under attack. In quick order, investigations by this Agency and other State Attorney Generals revealed that dozens of well known mutual fund families had turned large profits at the expense of mutual fund investors. Looking only at the top nine fund families, billions of dollars were literally stolen from mutual fund investors by executives who placed their personal gain above the interests of their investors whom they were sworn to protect. It became clear that many fund executives participated in sweetheart schemes in which privileged third parties such as hedge funds were allowed to market time mutual funds and to engage in late trading, siphoning off billions of dollars of fund value at the expense of unknowing and unsuspecting mutual fund investors.

Indeed the scandal and harm was so egregious that Republican Congressman Mike Oxley, who of course authored with Senator Paul Sarbanes the famed Sarbanes-Oxley Act, decided to study the situation. Long a champion of protecting investors, Congressman Oxley did his homework and wrote several strong letters of support for the SEC's subsequent independent Chairman rulemaking that is the subject of the Court's Remand. In his letter to the Commission dated May 20, 2004, Congressman Oxley noted

that he had been closely following the debate regarding the SEC's proposal to require independent fund Board Chairman. After reviewing publicly available information, the Congressman stated in his letter that "The statistics I uncovered are startling. Eighty-four percent of the mutual fund families implicated in the market timing and late trading scandals (sixteen of the nineteen mutual funds) have had management-affiliated chairmen [non-independent] at some point during the alleged or admitted violations." He noted the SEC's actions against Invesco Funds, Franklin Templeton Funds, Janus, Putnam, Strong Funds, and MFS Funds in particular, which collectively settled for a total of over \$700 million in disgorgement and penalties. Urging the Commission to adopt the proposed rule without amendment, Congressman Oxley went on to say, "I believe the Commission's independent chairman proposal would eradicate the self-dealing by interested, management-affiliated chairmen and its harmful effect on mutual fund shareholders."

Unfortunately, threats to mutual fund investors continue to be uncovered by our Agency. On May 31, 2005, for example, the Commission announced a settlement with Citigroup Global Markets, Inc and Smith Barney Fund Management. The Commission's Order noted that the investment adviser placed its interest in making a profit ahead of the interests of the mutual funds it had a duty to serve. In this case the adviser recommended that the mutual funds contract with an affiliate of the adviser to serve as transfer agent without fully disclosing to the mutual funds' boards that most of the actual work was to be done under a subcontract arrangement that had been negotiated with the mutual funds' existing third-party transfer agent at steeply discounted rates. Rather than passing the substantial fee discount on to the mutual funds, the adviser, through the newly created affiliated transfer agent took most of the benefit of the discount for themselves, reaping

nearly \$100 million in profit at the funds' expense over a five year period. The funds did not have an independent Chairman. Citigroup and Smith Barney paid over \$200 million in disgorgement and penalties.

## II. The Agency's Objective Has Been Investor Protection and to Restore Confidence.

In response to this explosion of mutual fund fraud and theft by adviser executives, the Agency moved promptly to protect investors. It designed a combination of new governance and compliance rules. One of these rules mandates that advisers establish chief compliance officers who report directly to the mutual fund board. The capstone however of the SEC's effort to protect investors and deal with a serious breakdown in management controls were the two conditions adopted on July 27, 2004 that are the subject of this Remand, that fund boards have at least 75% independent directors and an independent chairman.

The Agency's purpose in proposing the conditions was to protect investors from serious harm and from a breakdown in funds' existing controls and structure. In addition to investor protection, I and the other majority Commissioners were also very concerned that the mutual fund industry as a whole was under siege by the acts of a greedy few. Investor confidence in the integrity of mutual funds was damaged and needed to be restored. Our mission also to protect the integrity of the financial sector was being challenged. It is worth noting that the industry association the Mutual Fund Directors Forum also supports the rules because of their concern for the overall health of the industry, even though a significant fund family was against the rule.

## III. The Court of Appeals Upheld the SEC's Authority to Enact the Rules and Approved of the Rationale.

The two new conditions adopted by the SEC were challenged by the Chamber of Commerce, which submitted a petition for review to the U.S. court of Appeals of the District of Columbia Circuit. On June 25, 2005, the Court of Appeals issued its decision. The decision has been regularly been mischaracterized in the press.

The DC Circuit Court stated on page 2 of its opinion, “We hold that the Commission did not exceed its authority in adopting the two conditions, and the Commission’s rationales for the two conditions satisfy the Administrative Procedures Act.” The decision is meaningful because it clarifies the Commission’s authority to regulate the corporate governance of mutual funds under section 6(c) of the Investment Company Act and dispels the notion that such issues are left entirely to state law.

As the Court holds on page 12 of its opinion, “The Commission reasonably concluded that raising the minimum percentage of independent directors from 50% to 75% would strengthen the hand of the independent directors when dealing with fund management, and may assure that independent directors maintain control of the board and its agenda.” The Court also upheld the Commission’s conclusion that an independent chairman provides “a check on the adviser, in negotiating the best deal for shareholders . . . and in providing leadership to the board that focuses on long-term interests of investors.”

In considering both the 75% rule and the independent chairman requirement, the Court held, on page 12 of the opinion, “In sum, the Chamber points to nothing in the Investment Company Act that suggest the Congress restricted the authority of the Commission to make ‘precautionary or prophylactic responses to perceived risks’ and the Commission’s effort to prevent future abuses . . . was NOT arbitrary, capricious, or in any way an abuse of its discretion...”

IV. The Commission has Carefully Followed the Directions of the Remand with Respect to the Finding that the Commission Did Not Adequately Consider the Costs Imposed Upon the Funds by the Two Challenged Conditions.

The Court remanded to the Commission two deficiencies that it identified in the rule making. First, the Court held that, in connection with the statutory obligation to consider whether the conditions will promote efficiency, competition and capital formation, the Commission did not adequately consider costs associated with both the 75 percent independent board and the independent chairman conditions. Secondly, the Court stated that the Commission did not give adequate consideration to an alternative called the “disclosure alternative.”

The Commission in its Response to the Court’s Remand has carefully considered the adequacy of the existing record and the need for further fact finding to properly consider and to follow the Court’s direction on remand. Given that the Commission labored for over one year in studying the matter, it is not surprising that the existing record, developed through full notice and comment procedures, is vast and ample. Specifically the Commission had also previously sought and received comment on the costs of the two conditions and had further elicited comment on the disclosure alternative. It is clear under Circuit cases that the agency is free on remand to determine whether supplemental fact-gathering is necessary and sufficient to address on remand the court-identified deficiencies. Accordingly, after careful review, the Commission has determined that the existing record and information publicly available at the time of the

original adoption is a sufficient base on which to consider and follow the Court's directions on remand.

The proof of the sufficiency of the existing record is in the careful estimates of costs and calculations performed in the Commission's Response. The estimates and ranges track exactly the directions in the Court's Opinion for formulating the estimates for the costs of the two conditions. Conservative estimates have been made and cushions to cover all possible costs have been added to calculations.

The key conclusion is that under the most conservative estimates of costs for implementing the conditions, the total costs are minimal under any measure. As such, there is no reasonable basis for believing that any additional fact finding would alter in any way this conclusion. Indeed, as allowed for consideration under Circuit cases, the Commission's Response cites recent studies subsequent to the original adoption that confirm the original information. (See Response, FN 69)

The Commission also reanalyzes and discusses why the notice alternative is deficient. As explained, this alternative was previously considered and implicitly rejected. The Court's directions to expressly consider the alternative is accomplished in a full and adequate manner in the Commission's response.

V. Dispatch, Focus, and Diligence Does Not Equate to Inattentiveness or Failure to Analyze Carefully.

There has been a consistent reporting in the press that advocates for the Chamber's position claim that any action in response to the Court's remand that does not include a new notice and comment period is somehow improper and disrespectful to the Court of Appeals. Quite simply, that contention is absurd on its face. Immediate

attention and diligence and a focusing of staff resources to respond to the Court's Remand shows the utmost in respect and in placing the matter at the highest level of priority.

Quite frankly, this Agency prides itself in meeting impossible deadlines and turning around prodigious amounts of work in short time frames. Examples are innumerable. However, one clear example occurred during the last days of former Chairman Pitt's tenure from January 22, 2003 to January 31, 2003. In a ten day period, the Commission (with the same four Commissioners that enacted the rule in question, except for Chairman Donaldson), enacted no less than ten rulemakings, several on a twice a day schedule, and several being final rules or comments. The day after WorldCom filed a surprise restatement, this Agency had filed a lengthy complaint to move swiftly to protect assets for victims of fraud. This Agency never missed a deadline in fulfilling Congress' mandates to implement the requirements of Sarbanes Oxley, resulting in more rulemakings in one year alone, during 2003, than in any other decade in its history.

The ultimate refutation of the accusation to a rush to judgment is the ostensible high quality of the Commission's Response and the analysis therein.

VI. There is an Absolute Urgency in Moving Forward to Implement the Protections Judged Necessary by This Agency.

This Commission has concluded that serious threats exist to mutual fund investors. The Commission's judgment is that extra prophylactic measures in the two conditions involving the 75% independent board and the independent Chair will add significant benefits to investor protection to combat the types of fraud that have been

uncovered. The Court in its Opinion stated that such conclusions were reasonable and that there exists “no basis upon which to second guess that judgment.”

The Commission therefore has a binding obligation to implement as expeditiously as possible the subject rule to protect investors and also to aid sustaining investor confidence resulting in protecting the integrity of the markets. Quite simply, a variation of an old adage applies in this context: “Investor protection delayed is investor protection denied.” To not move quickly would be a violation of the duty of the Agency to protect investors and the markets.

There have been accusations that the Commission is doing something for that, for lack of a better term, is “sneaky” or devious in responding to the Court within the last days of this particularly constituted Commission. Again, this accusation is patently absurd. The Commission is not doing anything “under the cover of darkness.” The Commission acknowledges the fact that Chairman Donaldson is at the end of his service. This fact only adds to the urgency in that the full Commission that has thoroughly studied the issue should be the one to deal if possible with proper care with the Court’s instructions on Remand.

There is also another clear set of facts that the Commission must deal with. If it did not act expeditiously in responding carefully and fully to the Court’s Remand, a state of limbo will occur as to this rulemaking. There can be no prediction when the new Chairman and possibly other Commissioners will be nominated by the President and confirmed by the Senate. What is certain is that many mutual funds that are in the midst of implementing the new rules will be “left hanging” and may have to incur unnecessary or additional costs as they await finality on these rules.



Ultimately, if the Commission were not to have acted with speed and dispatch in responding to the Court's Remand, investor protection and integrity of the markets will not be served.

I for one must support the protection of investors and our markets.

Therefore, I conclude that the Commission had no choice but to act expeditiously and quickly in responding to the Court's Remand. The Commission was also in a position to prepare a thoughtful and quality response in short order.

Indeed, anyone who supports another course of action by the Commission risks hampering investor protection and places other interests above investors and the overall health of the markets.

I vote in favor of the proposed response to the Court's Remand and I support all of the substantive contents in the proposed response.