As has just been demonstrated by Commissioner Glassman, emotions have run extremely high in this area. There has been too much confusion and hyperbole—“hyperbole” is the most gentle word that I can use. Among others, I found her statement about the staff’s cost analysis being “back of the envelope” quite extraordinary. I reviewed the cost analysis with great care, and everyone knows how hard the staff has worked on it. It is a very serious cost analysis.

Let me begin a more serious discussion by making clear what the D.C. Circuit Court did—and did not do—on June 21st.

First, the Court expressly upheld our statutory authority to require mutual funds to have a board consisting of no less than 75% independent directors and an independent chair. In the face of claims of “regulatory overreach,” the Court held that the “Commission did not exceed its statutory authority” in adopting the two governance conditions.

Second, there were challenges to the wisdom and effectiveness of our mutual fund governance provisions. I have stated often that given the fundamental need for directors to deal with the inherent conflicts of investment managers, a critical mix of at least 75% of independent directors makes compelling policy sense. The Supreme Court has described mutual fund independent directors as necessary “watchdogs” to police mutual fund conflicts of interest. Similarly, an independent chair helps to ensure proper
information flows, establish sensible board priorities and agendas, and encourage candid and thorough discussions in the boardroom.

The D.C. Circuit Court recognized our prudence in “strengthening the role of independent directors in relation to exemptive transactions as a prophylactic measure . . . .” The Court held that our policy rationales for the two new governance provisions were justified.

Third, the Court then remanded in the two deficiency areas that have been identified, and asked us to address them.

An initial issue for us was whether it was necessary to engage in additional fact-gathering or further notice and comment procedures. We concluded that the information in the existing record (which had involved an extensive notice and comment process) provided a more than sufficient basis to address the deficiencies. The Circuit Court could, of course, have required us to do new fact-gathering, but did not do so.

Given what we believe is the adequacy of the information available in the record, there would be large costs to new fact-gathering. By acting promptly we avoid the cost of new fact gathering, avoid what could be a substantial period of uncertainty for mutual fund governance, and ensure that fund shareholders will receive the critical protections afforded by the new governance rules without further delay. The mutual fund business is based on investor trust, and, after the grievous breaches of trust disclosed by the mutual fund scandals, it is of great importance to continue to bolster investor confidence in the governance of funds.

This Commission has spent nearly two years considering mutual fund disclosure, governance, and other rules. As was true of our action today on “securities offering
reform,” we have labored too hard - - and the governance provisions are too important - - for us not to act in the public interest. As Chairman Donaldson put it, “failure to act would have a severe detrimental effect” on investors. Of course, as we have just done with respect to securities offering reform, a future Commission would be able to modify or reverse anything we do today that the new Commission concludes is counterproductive.

Let me now address briefly the crocodile tears being shed about the need to not move forward out of respect for the Court of Appeals. I believe that the release we will approve today fully responds to the Court’s concerns. I have great respect for our panel of three strong, highly intelligent and talented judges. This matter will quickly be back before those judges. If we are wrong about being fully responsive, the Court will certainly tell us so. But, if we are right about being fully responsive, we will have ensured an enormously better day for investors in mutual funds. As the Circuit Court recognized, our two governance rules are designed to strengthen the independence and effectiveness of fund boards, and thereby, protect shareholders from serious conflicts of interest.

Obviously, for me, in an $8 trillion industry, the benefits of the two new governance provisions plainly and overwhelmingly outweigh their costs.

A full discussion of the “disclosure alternative” to the independent chair provision is contained in our release. For now, let me just emphasize again that the interrelation between investment advisers and mutual funds presents complex and pervasive conflict-of-interest issues.
The dynamics of a mutual fund boardroom - including what may be the dominance of the chair (who often controls information flows, board agendas, etc.) - is extremely difficult to disclose in a meaningful way. It is similarly difficult for the 90-plus million shareholders of mutual funds to digest and evaluate. But those of us who have spent most of our professional lives working on issues of corporate governance - and have witnessed the failings of mutual fund governance demonstrated by nearly two years of enforcement actions - fear that permitting investment managers to continue to chair mutual fund boards would significantly increase the danger of future abuse.

I think the same reasoning convinced Congress in 1940, in enacting the Investment Company Act, to go well beyond disclosure and provide both Exemptive Rules (prohibitions against transactions involving conflicts of interest) and detailed prescriptions for the organization and governance of mutual funds. As we said in our July 2004 Adopting Release: “[the chair of a fund board] is in a unique position to set the tone of meetings and to encourage open dialogue and healthy skepticism.” An independent chair can both help to counterbalance the fund’s investment adviser and provide leadership that makes paramount the interests of fund investors. Put bluntly, the disclosure alternative does not afford adequate protection to fund shareholders. In this area, it is simply an unrealistic idea.

Finally, this is Chairman Donaldson’s final public meeting. I must express my deep sadness - both on a personal level and for all decent participants in our financial markets - at his leaving. Bill, you have played a major role in restoring investor faith in the integrity and fairness of the nation’s financial markets. You have also restored the
public’s faith in the SEC. Your leadership, honesty, and courage will long be celebrated, and you will be greatly missed.

The Commission staff has done a splendid job on this release. Mike Eisenberg, Bob Plaze, Giovanni Prezioso, Jonathan Sokobin, and all the rest of you, thanks for your terrific effort.

I have no questions.