

**Dissent of Commissioner Cynthia A. Glassman
To the Commission Response to Remand by Court of Appeals
Investment Company Governance**

I disagree with this rush to respond to the Court's remand of the "independent chair" rulemaking in the strongest possible terms. Last fall, the Chamber of Commerce of the United States of America challenged two provisions in the Commission's mutual fund governance rule, adopted over my and Commissioner Atkins' dissent, in July 2004, namely, the requirements that investment companies relying on our exemptive rules have an independent chair of the board of directors and a board composed of at least 75 percent independent directors. Last Tuesday, June 21st, the United States Court of Appeals for the District of Columbia Circuit granted the Chamber's petition requesting the Court to set these requirements aside and prohibit the Commission from implementing and enforcing them. In its unanimous decision, the Court held that the Commission violated the Administrative Procedures Act, or the APA, by failing adequately to consider the costs mutual funds would incur in order to comply with the conditions and failing adequately to consider at least one reasonable proposed alternative to the independent chair condition. The Court therefore remanded the proceeding to the Commission to address the deficiencies identified by the Court.

In my view, a prudent response to the Court's mandate would be for the Commission to seek public comment on the issues identified by the Court as violating the APA. Instead, if this action is approved, the agency, through a chairman who is resigning effective tomorrow, will have elevated form over substance once again.

On the same day that the Court issued its decision, I received an e-mail message from the Chairman's chief of staff informing me, without prior consultation, that the staff had reviewed the Court's opinion and "concluded that the court's concerns can be addressed on the basis of the record already before the Commission." As such, the Chairman determined that this matter would be on today's open meeting agenda – a mere week following the Court's remand. While the Commission has an excellent and hardworking staff, it is simply not possible to conduct a thorough review "of the record" in this time frame. The fact that the decision to hold today's meeting was made just hours after the issuance of the Court's decision further demonstrates the cursory nature of the "review." It does not require a clairvoyant to discern the real reason for the rush to judgment – indeed, much to my surprise, the proposed release openly states it – the Chairman has announced his resignation effective tomorrow and therefore this meeting must be held today. What is not expressly stated in the release, but is equally clear, is the majority's fear that in the absence of the Chairman's participation, the rule will not be implemented. This concern, whether real or imagined, does not justify ignoring the Commission's obligation to address properly the APA deficiencies found by the Court.

Before addressing some of the substantive problems with the proposed release, it is important for the public to understand the procedural deficiencies surrounding this proceeding. To begin, the procedure employed by the Chairman in placing this matter on the agenda today was unusual. The Code of Federal Regulations requires that we provide a "sunshine notice" of an open meeting. An individual Commissioner known at the "duty officer" typically signs this notice. The designation of duty officer rotates weekly among the Commissioners, but not the Chairman. Last week, I was the designated "duty

officer.” Nonetheless, I did not learn until the next day that the Chairman had instead opted to serve as the duty officer for this matter and “sign off” on the notice. To the best of my knowledge, the Chairman has never previously served as duty officer during his tenure and his decision to do so – in this matter only – is without precedent.

A claimed rationale for proceeding on the matter today is that it is “important and appropriate for the same five of us to address the issues raised by the Court on remand” because of our “unique familiarity with these matters.” This is ludicrous – I do not believe and I challenge the majority to find any support for the notion that only those involved in a particular rulemaking have enough knowledge to effect any changes to it. Indeed, if this observation were true, the agency’s regulations would be set in stone and could never be modified once there was a change in the Commission’s constitution.

More disturbing is the statement in the action memorandum circulated with the proposed release “request[ing] that any concurring or dissenting statements be circulated prior to the meeting” today. This is yet another new procedure unique to this proposal. The stated basis for this request is to allow any such statement to be published contemporaneously with the release, because it is contemplated that the release will be adopted today and published before the Chairman’s departure. What this really shows is that the issues have been “pre-judged,” which is a violation of our duty as Commissioners and yet another reason to believe that this matter will not survive a legal challenge. In any event, as a practical matter, no “advance copy” of a dissent was possible given the compressed time frame for this meeting and the fact that the staff continued to revise the proposed release up until and including yesterday evening. I request that this statement

accompany the release and serve as my dissent pending an opportunity to provide a more formal dissent after I have had an opportunity to review the release as adopted.

Turning to the proposed release, on Friday evening, June 24, the staff circulated a 27-page draft of it. This draft, produced a mere three days after the Court's opinion, contains what can only be described as a back of the envelope calculation of costs that rest largely on the staff's "estimates" and "judgment" – two buzzwords used repeatedly in the release. Subsequent drafts were circulated late Monday and Tuesday evening. Numerous revisions were made to each draft to which I have not been afforded adequate opportunity to review. I have no way of determining whether there is any validity for the cost analysis and the context for these costs. For example, how do these costs relate as a percentage of a fund's total expenses?

I need not dwell on the failings of the proposed release. It is sufficient to state that the release is an assembly of false statements, unsupported assumptions, flawed analysis, and misinterpretations. However, one often-repeated statement in the release – that the Commission can address the Court's concerns on the basis of the record already before the Commission -- must be corrected. To be clear, the Commission cannot address the Court's concerns on the basis of the record already before the Commission. It cannot address the costs because, contrary to whatever representations the staff makes today, the Commission has repeatedly and consistently represented to the Court, to Congress and to the public that it has "no reliable basis for estimating" the costs. This statement, both in connection with the costs associated with electing independent directors, and with the costs incurred by an independent chair hiring staff, appears

repeatedly in the proposing and adopting release, in the Commission's brief to the Court, and most recently, in the April 2005 staff report submitted to the Congress which submission was mandated by the Consolidated Appropriations Act of 2005. It strains all credibility to believe that the Commission, professing for the past year and a half its lack of a reliable basis, has mystically within the past week been able conclusively to estimate costs associated with the rule.

More fundamentally, the Commission cannot address the costs associated with the independent chair's hiring of staff and experts because it expressly declined to ask for comment on this issue. Specifically, in part V.B. of the proposing release, published in January 2004, the Commission recited that the proposed release would require: (1) an independent director to be chair; (2) directors to perform an annual evaluation of the board; (3) independent directors to meet in executive session at least quarterly; and (4) independent directors be given specific authority to hire employees. Immediately thereafter, the release states: "We request comment on the costs of the first three items above, and on whether boards would choose to hire employees." Although the last version of the proposed release I received last night continues to state that we "specifically sought and received comment" on this cost, it is indisputable that we have never solicited comment on the costs associated with the hiring of staff – one of the very issues that the Court has now directed the Commission to address on remand.

In an apparent effort to bolster the argument that the Commission had, in fact, considered costs based on the record before it, the proposed release indicates that information "publicly available at the time we originally adopted the amendments" is sufficient to base the Commission's current discussion of costs. The latest version of the

release now also includes a passing reference to “supplementary public information” without elaboration. It is curious indeed that in proposing this release the Commission has forgone examining subsequent data of real costs that mutual funds have incurred since the adoption of this rule last year as these funds prepare for the rule’s implementation date. It is even more curious that the purported basis to exclude actual data rests on the theory that our estimate of costs is on the “high end of the range” rendering an examination of actual data unnecessary. This logic is backwards – it is the actual data which makes estimates unnecessary. As an economist, I cannot accept estimates and “best judgments” to support a cost/benefit analysis when actual costs are readily available and can easily be obtained through a request for public comment.

Likewise, the Commission cannot on the basis of the record before it address the alternative proposal identified by the Court that each fund be required prominently to disclose whether it has an inside or an independent chair and thereby allow investors to make an informed choice. When the Commission initially sought comment at the proposal stage, it did not seek specific comment on whether disclosure was a viable alternative. Rather, the Commission only asked generally for comment on alternatives, followed by a series of specific alternatives that did not include disclosure. Nonetheless, today’s proposed release attempts to suggest that robust comment on a disclosure alternative was solicited, citing two comment letters that briefly mention -- and I might add support -- disclosure as an alternative. It is noteworthy that the staff, in compiling for us a summary of the 200 plus comment letters to this rulemaking, did not include any reference to disclosure as alternative. This is because this issue simply was not addressed in more than a handful of these letters.

As the Commission conceded in its brief to the Court, the truth of the matter is that the Commission did not consider “all” alternatives in adopting the rule because, in the majority’s view, the Commission was not required to do so. Implicit in the single paragraph in the Commission’s brief devoted to this significant issue is the acknowledgement that no consideration was given to a disclosure alternative, even though this alternative provides the Commission with a rule-making option that, as the Court observed, is “neither frivolous nor out of bounds.”

The proposing release rejects disclosure as an inadequate alternative on the basis that it would not protect investors from the “potential abuses inherent in the conflict-of-interest transactions permitted under the exemptive rules.” In its remand opinion however, the Court dismisses this argument as irrelevant, finding instead that the fact the Congress in the Investment Company Act required more than disclosure with respect to some matters governed by that statute does not mean that Congress deemed disclosure insufficient with respect to all matters. Without soliciting comment on this issue, we have no basis to discern whether the public would or would not find disclosure meaningful. Nonetheless, the release concludes that disclosure would not be meaningful, citing a recent speech in which I questioned the length of fund prospectuses. Not only does this argument misinterpret what I said, but it leads to the illogical conclusion that once a prospectus reaches a certain length, it is full and therefore no additional information can be added.

The proposed release indicates that a reason for proceeding today is because expedited consideration is necessary in order to protect investors. For the reasons stated above, this statement is completely disingenuous. The case has never been made to my

satisfaction that the benefits of this rule are more than cosmetic. In this regard, the Chairman's reference to market timing scandals at mutual funds with an interested chair as warranting the rule is misplaced. The share of these scandals at funds with interested chairs versus independent chairs was proportionate to their share of funds. In any event, in my view, protection of investors compels that we carefully consider the costs and alternatives before rushing to judgment. To allow this open meeting to proceed as if the Commission can simply fill in the blanks for APA deficiencies, without requesting public comment on these significant issues, makes a mockery of the process. Today's action is nothing more than window-dressing. It violates the spirit, if not the letter of the Court's opinion, which in directing the Commission to address the deficiencies, clearly contemplated that the Commission would do so by applying "its expertise and its best judgment" to bear. Rather than attempt in good faith to respond appropriately to the Court's direction, the Chairman has hastily scheduled this meeting designed to give the appearance that the Commission has judiciously considered its prior APA deficiencies, but in reality, is simply an attempt to obtain the same result without any serious examination of the costs associated with the rule and the alternatives available.

One additional point is worth mentioning. While the Chairman has refused to allow a public comment period for this proceeding, the public has not been silent in the past week. The Commission has received letters and statements from former Commissioners (including at least one Chairman), former staff, and trade associations, and there has also been much media coverage. Many of these public comments voice their opposition to the manner in which this proceeding has been conducted. They question the timing of this proceeding, the lack of public input into the process, and the

likely long-term damage that will result to the agency as a result of operating in this fashion. While we are responding to these letters in our release, it is my understanding that the letters will not be posted to our website for public review.

Accordingly, for all the foregoing reasons, I am compelled to vote against the proposal. In closing, I would like to take this opportunity to apologize. First, to the Court, for the agency's failure to respond appropriately to the Court's directive to undertake a meaningful review. Second, to those staff members who were uncomfortable having to participate in this exercise. And third, to the public, which must continue to live with the uncertainty surrounding the legality of a rule that was adopted in violation of the APA and, after having already been stricken by a Court, will most certainly be challenged again as a result of our action today.

I have one question. The most recent version of the release has added a new footnote 15 which states that: "Even prior to our having issued this Release, there have been reports that additional legal proceedings may result from our action today. Accordingly, we are instructing our Office of the General Counsel to take such action as it considers appropriate to respond to any proceedings relating to this rulemaking." I have never seen this before.

- Have we ever done this before?
- What does it mean?
- What is the effect?

Addedum June 30, 2005

These dissenting remarks are based on the draft release circulated Tuesday evening, June 28, 2005 for the open meeting held at 10:00 a.m. on June 29, 2005. The final post-meeting release has been changed by the majority apparently in reaction to some of the procedural deficiencies noted in my dissent. These changes do not cure those deficiencies, however they may make some of my references at the meeting to statements in the release appear inapposite. As an aside, footnote 15, which the general counsel refused to explain in response to my questioning at the open meeting, has now been renumbered footnote 14.