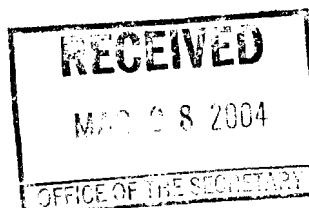


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Robert H. Wadsworth  
6732 E. Fanfol Drive  
Paradise Valley, Arizona 85253

March 4, 2004

Mr. Jonathan G. Katz  
Secretary  
U.S. Securities and Exchange Commission  
450 Fifth Street, NW  
Washington, DC 20549-0609



Re: Investment Company Governance  
File No. S7-03-04

Dear Mr. Katz:

The purpose of this letter is to comment on Investment Company Act Release No. 26323 (the "Release") and the proposed rules contained therein.

I have worked in the investment company industry since 1965. During that time, I have been both an interested director of funds and a "disinterested" director (to use the term as defined in the release). I have also, in other capacities, attended many meetings of the boards of directors of numerous fund complexes. Accordingly, I believe I have ample experience with investment company governance.

I do not disagree with the statement that it is appropriate to revisit governance of funds, although I believe that the publicity given to recent events in the industry overlooks the fact that the majority of funds have not experienced the problems that have generated this publicity, and in any event, the problems do not appear rooted in fund governance but rather in investment adviser compliance. Accordingly, I think it is important that changes to governance be intended to resolve actual, not perceived, problems.

My specific comments on the Release are as follows:

1. *Board Composition.* Because all major decisions made by directors are currently required to be taken by independent directors (*e.g.*, approval of management contracts and 12b-1 plans, selection of auditors), it is my belief, based on my experience, that the number of interested directors on a board has absolutely no effect on these decisions, notwithstanding the opinions of some academic observers. However, if the Commission determines to increase the percentage of directors to 75%, I wish to point out two unintended consequences of this change.

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Because the 75% level significantly reduces the number of directorships that may be occupied by interested persons – only 2 for board sizes of 8-11 persons and only one for sizes of 4-7 – most boards will be able to have only one, or perhaps two, interested persons as directors.

First, as the Commission has itself noted, there is no definition of an “independent” director. Such a director is simply someone who, by default, is not an “interested” director. However, an interested director is not necessarily someone who is affiliated with a fund’s advisor. In my own experience, I know of a director who has extensive experience in the securities industry, but who is also “interested” because of his affiliation with a broker-dealer with which the fund conducts some brokerage. Nevertheless, he has no affiliation with the fund’s advisor. This director, because of his experience, makes valuable and substantive contributions during board meetings. If that director is forced to leave that particular board because of the adoption of this requirement, the unintended consequence will be to deprive the board of the knowledge and experience of that director. Accordingly, I suggest that the Commission apply the supermajority requirement only to directors who are not *affiliated* persons of the adviser or distributor. Because directors who are not *interested* persons will comprise the nomination committee and because approval of essential contracts will continue to be the sole responsibility of those directors, I believe it will be in the public interest to give boards the freedom to include a larger number of such interested, but not affiliated directors.

Second, I believe that it is healthy for representatives of the management company to participate in board meetings, by helping them understand the concerns of the independent directors. Driving the investment advisory personnel away from fund governance – the other unintended consequence of a supermajority – is not desirable.

2. *Independent Chairman of the Board.* I recognize that the proposal that the chairman of the board be an independent director is also popular within the media, and among some legislators and activists, but I believe that the potential drawbacks of this proposal argue against giving in to public opinion. Most uninformed observers equate the chairman of a fund board with the CEO of an operating company, such as former GE chairman Jack Welch, who reportedly threatened to resign if GE’s board were ever to have a session at which he was not present. A fund chairman, on the other hand, acts primarily as a moderator, seeing that the meeting adheres to the agenda and calling for votes when necessary. There are ample opportunities for independent directors to make their concerns heard. Specifically, the audit committee, which already has an independent chairman and meets with independent auditors without management representatives present, offers an opportunity for independent directors to raise their own questions. In addition, I believe that it is good practice for independent directors to meet in “executive session” with their own independent counsel (and I comment below on the

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Commission's proposals on this subject), and I believe that following that practice also gives independent directors sufficient influence over board agendas and meetings that an independent chairman is an unnecessary requirement.

I have had experience with boards with independent chairmen, and I believe it is possible for there to be negative unintended consequences. First, it is possible for the chairman to be unintentionally coopted to management's side, simply as a result of the increased amount of contact with representatives of the management company. Second, I am convinced that it is tempting for the remaining independent directors to become less diligent themselves and to rely on their "independent chairman" to mind the store.

While I do not believe that there is any evidence to support the idea that an independent chairman is necessary for good governance, if the Commission is determined to "do something," then I suggest it follow the approach contained in an amendment proposed by Congressman Miller and included in the latest version of HR 2179, providing that a fund that does not have an independent chairman instead have an independent director with the power to call meetings, place items on the agenda, etc.

3. *Annual Self-Assessment.* I endorse the proposal that boards engage in annual self-assessment. However, I do not think it is desirable that the Commission should go into undue detail about its requirements for self-assessment. I believe that the more specific the rule becomes, the greater the danger that a board will adopt a ritual of complying with those specifics. The NYSE and Nasdaq have adopted this approach of a general requirement for listed operating companies. If the Commission has specific concerns about how Boards operate and wants Boards to consider these issues in self-assessments, it has other mechanisms to make its views known, such as interpretive releases.

4. *Separate Sessions.* I strongly support the requirement for separate sessions and believe they should be required at every regular meeting of the board. If the independent directors find that they have nothing to discuss, they can adjourn their executive session.

5. *Independent Director Staff.* I see no harm in having a rule that explicitly permits independent directors to have their own staff, although I do not believe that directors should be *required* to do so. On the surface, it appears that staff support for the board that is independent of the management company is a good idea, and would do more to improve governance than, say, having an independent chairman. However, a business school professor whom I respect has

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observed to me that independent staff personnel would probably “go native” in the environment they would inevitably find themselves working in.

An alternative solution would be to make it clear that independent directors have the power to retain independent resources, such as consultants, on their own if necessary to provide the board with additional expertise. This is the approach that the NYSE and Nasdaq have taken for listed operating companies.

Accordingly, I think the decision as to staff for the directors should be left to the independent directors themselves.

6. *Independent Legal Counsel.* I appreciate the Commission’s having requested comment on the desirability of independent legal counsel for independent directors. I think that this would be the single most effective requirement for improving governance of fund boards. Independent counsel would make it unnecessary to have an independent chairman, because counsel would be able to provide input on the board’s agenda. Experienced independent counsel are in a position to assist a board with self-assessment. The resources of the independent counsel would (and already often do) serve in many cases as the staff for the independent directors.

I have only one reservation about this requirement: I am concerned about the financial impact on smaller fund groups – a point I will address in more detail below.

7. *Recordkeeping for Approval of Advisory Contracts.* Funds should certainly be required to retain the materials used in connection with the approval of contracts with the advisor, as well as all other service providers. It has been my experience that this has been current practice for the vast majority of funds.

8. *General.* The investment company industry has always been one with low barriers to entry, and I believe that this has been one of its strengths. However, all the regulatory burdens that have been imposed in the last few years have caused a significant increase in the work associated with managing a fund.

Based on my own experience, I can cite an example. Slightly more than ten years ago, I helped an investment advisor start a mutual fund. The fund was intended primarily as a vehicle for investors who could not meet the advisor’s minimum account sizes. It has no sales load or 12b-1 fees and has never been aggressively marketed. Today, it has only some \$100 million in total net assets. At this point, the advisor earns a decent advisory fee, but he also undertook risk

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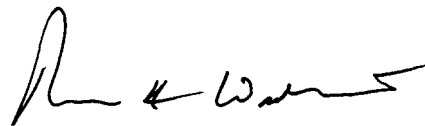
in starting the fund and subsidized its operating expenses for several years. This fund has consistently outperformed the S&P 500 since inception, so its shareholders have clearly benefited. However, I am certain that, were today's regulatory climate in existence ten years ago, this investment advisor would never have entered the fund business.

I also find it ironic that, at a time when there is widespread concern about the ability of the social security system to provide adequate benefits for retirees in the future, when many observers believe that it is essential for our citizens to be investing on their own, and when mutual funds represent the most common means for the public to participate in equities, the Commission is constantly adding unnecessary hurdles.

Accordingly, I believe that the Commission should give serious consideration as to whether it is good public policy to make the regulatory barriers so high that an investment adviser considering whether or not to start a mutual fund will decide against it – perhaps deciding instead to offer an unregulated vehicle such as a hedge fund. As it did several years ago, the Commission may also wish to review again all fund regulations and consider whether some may be streamlined or eliminated in light of experience and current practice.

I appreciate the opportunity to offer these comments on the Release and the proposed rules contained therein.

Sincerely yours,

A handwritten signature in black ink, appearing to read "R. H. Wadsworth". The signature is fluid and cursive, with a large initial "R" and a long horizontal stroke at the end.