August 21, 2006

Ms. Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Dear Ms. Morris:

The Mutual Fund Directors Forum appreciates the opportunity to further comment on the Commission's rules requiring that all funds have a board headed by an independent chair and composed of at least 75% independent directors.[1] The Forum, a non-profit membership organization composed solely of mutual fund independent directors and trustees ("directors"), is dedicated to assisting independent mutual fund directors meet their responsibilities to protect the interests of mutual fund shareholders.

As we discuss below, it is abundantly clear that fund shareholders obtain significant benefits when the board of their fund is composed of a supermajority of independent directors and is headed by an independent chair. The strong, independent governance system assured by this structure is also likely to increase investor confidence in mutual funds, and thus benefit the capital formation process and capital markets generally. Finally, there is substantial evidence that the costs of converting to and maintaining a board structured in this manner are negligible in relation to fund assets or other far more significant operating expenses, such as fund advisory fees. In light of these facts, the Forum strongly reaffirms its previous conclusion that mutual funds should be encouraged, as a best practice,[2] to have an independent chair and a board composed of directors at least three-fourths of whom are independent.[3]

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1 In response to the decision of the United States Court of Appeals for the District of Columbia in *Chamber of Commerce v. SEC*, 443 F.3d 890 (D.C. Cir. 2006), the Commission requested additional comments on its proposed governance amendments. *See* Investment Company Governance, Investment Co. Act Rel. No. 27395 (June 13, 2006).

2 In recommending best practices, the Forum recognizes that each fund and fund family is unique, that fund directors need to assess whether a particular practice makes sense for a particular fund, and that in some circumstances the independent directors of a fund may reasonably conclude that the recommended governance structure may not be in the best interests of their fund's shareholders.

3 Although it is the Forum's recommendation that the Commission endorse these governance enhancements as best practices, the Forum's Board of Directors unanimously recommends that the

I. Introduction

This is the third time that the Commission has considered whether to require funds' boards to be composed of 75% independent directors and to have an independent chair. On two prior occasions, the Commission concluded that these two governance enhancements would produce substantial benefits for fund shareholders at a relatively minimal cost.[4] While the Commission's rules have twice been rejected by the D.C. Circuit, the court has never questioned the Commission's conclusions about the benefits of the rules or even of the costs imposed by the rules. Rather, in each case, the court has identified inadequacies in the Commission's rulemaking process and thus remanded the rules to the Commission for further consideration.[5]

As outlined in more detail below, the Forum agrees with the Commission's conclusions that these two governance enhancements will result in significant benefits for fund shareholders at a minimal cost. We have twice surveyed our members – many of whom have voluntarily adopted these approaches to governance – and in each case, the reported experience of our membership has affirmed that these changes are not costly to implement or maintain.

The Commission's current request for comment focuses primarily on the costs of these changes. In order to assist the Commission in understanding the costs involved, we are submitting with this letter the results of our most recent survey of Forum members. However, even in a situation like this, where the costs appear minimal, they cannot be discussed or analyzed in isolation. Rather, costs must be analyzed in the context of the benefits that the requirements produce. Hence, before discussing costs, we turn to a brief discussion of the benefits of an independent chair and a board composed of 75% independent directors.

II. Benefits of the Commission's Proposed Governance Enhancements

A. The Role of Independent Directors

Mutual funds today are one of the most important vehicles through which Americans save for their retirements, their children's educations and other key goals. However, mutual funds are not only a means through which Americans save for their future, they are also a key vehicle through which Americans become and remain owners

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Commission mandate these governance enhancements. This recommendation of the Forum's Board of Directors does not represent the views of all Forum members in every respect.

4 *See* Investment Company Governance, Investment Co. Act Rel. No. 26520 (July 27, 2004) and Investment Company Governance, Investment Co. Act Rel. No. 26985 (June 30, 2005).

5 On July 20, 2006, the Court of Appeals for the D.C. Circuit issued a mandate to the Commission vacating the rules requiring an independent chair and 75 percent independent directors. Therefore, federal law currently permits funds to have an interested chair and requires only that most fund boards be composed of a simple majority of independent directors.

of our nation's economy. Because mutual funds are such a significant means by which the savings of all Americans are put to use in the marketplace, they are fundamental to the vibrancy of our country's capital markets and the continuing growth of our economy. The benefits of these two independence enhancements is hence best measured in terms of (i) whether they can help make mutual funds a more effective investment vehicle for ordinary Americans and (ii) whether the enhancements indirectly strengthen our capital markets by increasing the willingness of ordinary Americans to use mutual funds.

The willingness of Americans to continue to invest in mutual funds has important implications both for the long-term success of individual savers and the long term success of our nation's economy. It is, therefore, critically important that mutual funds be managed in the interests of the many millions of Americans who are their owners. Encouraging mutual fund boards to have at least 75% of their members be independent and to have an independent chair is an important step toward assuring that this objective is reached.

The American mutual fund is structured in an ingenious fashion. By pooling investors' money into a separate entity, either a corporation or a business trust ("corporate entity"), funds can accomplish two objectives: they permit investors to obtain the benefits of diversification and professional management while at the same time allowing multiple small investors to act, through their fund's directors, as a single large investor in negotiating for an adviser's services and monitoring its performance. The directors of a fund thereby represent the combined buying power of its shareholders in negotiating with the adviser and further stand in for shareholders by monitoring the investment performance and conduct of the adviser and other service providers to a fund.

Put simply, fund regulation and fund governance are thus rooted in a very specific principle – funds are owned by their shareholders, so those who manage the funds must act in the shareholders' best interests.[6] Fund advisers perform a critically important role in the formation and management of funds, but they are not the funds' owners – rather, they are hired by funds and their shareholders.

Fund directors, in contrast, are the representatives of their funds' shareholders. Not surprisingly, both the Congress and the Commission have long recognized that fund shareholders benefit when fund directors perform their functions -- in other words, when

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6 Some commentators have opposed the Commission's approach to the regulation of fund governance on the grounds that it makes more sense, particularly from an economic perspective, to treat funds as if they were products being sold by advisers to investors rather than corporate entities owned by their shareholders. *See, e.g.,* Paula Tkac, "Mutual Funds: Temporary Problem or Permanent Morass?," *Federal Reserve Bank of Atlanta Economic Review,* Fourth Quarter 2005, at 19-20; Harvey Pitt, "Over-Lawyered at the SEC," *Wall Street Journal*, July 26, 2006 at A15. While we disagree strongly with the conclusion that investors would be better served if funds were understood as "products," no matter what the merits of this argument, the Commission must regulate funds in the context of current law. And the law is clear – the Investment Company Act begins from the premise that mutual funds are entities that are owned by their shareholders. The governance of funds as well as the manner in which the Commission regulates governance must reflect this bedrock legal principle.

fund governance is effective. They have also understood that one of the prerequisites of effective governance is appropriate regulation of the governance process. As the law recognizes, boards cannot effectively represent their shareholders unless the board itself acts independently of the adviser and is not subject to any exertion of undue influence by the adviser. Without this independence, key functions entrusted to the board – functions that include negotiating the advisory contract, evaluating the adviser's performance and monitoring how the adviser handles the conflicts inherent in managing fund shareholders' money – risk being performed in name only, rather than on behalf of shareholders in a rigorous, arm's-length fashion.

This is not a new principle. As originally adopted in 1940, the Investment Company Act required that at least 40% of the members of a fund's board be independent. Hence, from the beginning of the modern era of fund regulation, it has been understood that fund investors are better served if independent directors who have no direct interest in the success or failure of the management company monitor the way in the fund is managed on their behalf. The task is to identify the factors that are most likely to result in an independent board that effectively represents shareholders' interests in its oversight of fund operations. As the Commission has correctly recognized in its two prior releases, a supermajority of independent directors and an independent board chair can be crucial elements of a governance structure that can help to accomplish this goal.

B. The Impact of Having a Supermajority of Independent Directors

Today, there is widespread agreement that fund investors are best protected when fund boards have a supermajority of independent directors. Most notably, the Commission itself has twice voted to require that most funds have a board that is 75% independent. In analyzing fund governance in 1999, the Investment Company Institute ("ICI") concluded that at least two-thirds of the members of fund boards ought to be independent, stating that such governance principles were necessary to "help assure that individual issues are addressed and resolved in a manner consistent with the best interests of America's more than 70 million mutual fund investors."[7] And, in our own more recent "Best Practices Report," the Forum, like the Commission, concluded that, as a best practice, three-quarters of the members of a fund board should be independent:

> This standard of independence should strengthen control over the full board's voting or approval process by those directors not affiliated with the adviser on all

7 Investment Company Institute, Report of the Advisory Group on Best Practices for Fund Directors: Enhancing a Culture of Independence and Effectiveness at 4 (June 1999). More specifically, the ICI Report notes that although moving to a supermajority of independent directors is "not without cost," the "benefits of a two-thirds standard justify recommending it as a best practice," at least in part because a supermajority of independent directors "will help assure that independent directors control the voting process, particularly on matters involving potential conflicts of interest with the fund's invest adviser." *Id.* at 10, 11.

matters generally and in particular on those matters in which the adviser's interest may conflict with those of the fund's shareholders.[8]

There is a sound basis in good policy for these supermajority recommendations. As the Commission recognized when it originally adopted the rules, fund boards play a key role in ensuring that advisory fees and other management practices are fair to fund investors. Directors not only negotiate the cost investors pay for the professional management of the fund's adviser, but also, in accordance with the requirements of the Act and the Commission's rules, closely monitor the manager to ensure that it does not abuse the conflicts inherent in money management to benefit itself at the expense of fund shareholders. While the point of strong board independence is not to create artificial conflict between the board and the adviser, it is the case, as the Commission emphasized when it adopted the rules, that there are significant questions regarding the ability of a management-dominated board effectively to undertake these important tasks.

In other words, to represent shareholders effectively, the board itself must be independent of the adviser. In contrast to a management-dominated board, a Board consisting of a supermajority of independent directors can help to set the tone of independence in the boardroom that ensures that boards are, in fact, the direct representatives of the shareholders that own the fund. A supermajority of independent directors also strengthens the control of the independent directors over issues brought to the Board in which the adviser's interest is potentially in conflict with the interests of fund shareholders. At the most fundamental level, it is the experience of our members that a fund board with a supermajority of independent directors has a greater ability to protect effectively the interests of its shareholders.

C. The Impact of an Independent Chair

Along with a supermajority of independent directors, an independent chair can serve as the linchpin in creating and maintaining a fund board that can effectively represent and protect the interests of shareholders. Far more significant than the combination of a supermajority of independent directors, executive sessions and a lead director, an independent chair assures independent director control over the fund's governance by, most importantly, enabling independent directors to call meetings whenever they deem necessary and control meeting agendas, the order in which topics are addressed, the time devoted to each issue on the agenda. More generally, an independent board under the leadership of an independent chair can establish a tone and tempo of board meetings most likely to encourage them to ask their fund's adviser penetrating and appropriate questions.

An independent chair also serves as a key focal point for the gathering of information for the board. An independent chair can also more effectively focus the concerns of other members of the board by collecting, consolidating and bringing their

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8 Mutual Fund Directors Forum, *Best Practices and Practical Guidance for Mutual Fund Directors* at 7 (July 2004).

concerns to the attention of the management company. Because fund shareholders do have an interest in the ongoing success of the adviser, an independent chair can also effectively develop and convey to other board members an unbiased view of the business of the adviser and the business concerns of the adviser regarding the management of the fund.

Further, the presence of an independent chair cannot easily be isolated from the other governance principles. Rather, having an independent chair is essential to the effective operation of the entire panoply of investor protection regulation in the fund industry. For example, consider the requirement that fund boards negotiate the fund's annual contract with its adviser. Shareholders clearly wish to obtain the best possible service at a fair price. In reviewing the contract with the adviser, it is obviously key that the board be independent – absent real independence, the board is in no position to conduct an arm's length negotiation with the adviser. If an interested chair is a key employee of the adviser or a substantial amount of the chair's net worth consists of interests in the adviser, the review process can be criticized on the basis of an appearance that the adviser is negotiating solely with itself in setting the terms of the contract without the shareholders' interests being adequately represented. To avoid this criticism, best practice calls for an independent chair to lead the negotiation.

Consider also the recently-imposed requirement that all funds have a chief compliance officer ("CCO"). A fund's CCO serves a crucial function – the CCO monitors the fund's and the adviser's compliance with the securities laws, and provides information about the fund's and adviser's compliance to the fund's board. Because the CCO works for the fund's board, the CCO's primary contact is likely to be the board's chair.

The CCO's loyalties may easily be divided between the adviser and the fund.[9] In circumstances when the CCO brings a problem – or even nothing more than a troubling occurrence – an independent chair is more likely to ask the probing questions and assure the necessary follow-up that will lead to an appropriate resolution of the CCO's concerns. If, however, the conversation occurs between a CCO and an interested chair who owes duties to the adviser or otherwise has a financial interest in the adviser's profitability, the type of probing conversation and fulsome follow-up that will lead to the early identification and resolution of problems is less likely to occur. The presence of an independent chair goes a far way toward mitigating this issue.

III. Costs of the Commission's Governance Requirements

The costs to a fund of establishing a board composed of 75% independent directors with an independent chair, are minimal. The attached appendix summarizing

9 For example, the CCO may serve in other similar capacities at the adviser, may receive compensation for those services based on the performance or profitability of the adviser, or may have a significant investment in the adviser through the receipt of options or otherwise.

the Forum's survey of our membership demonstrates that those funds that have added independent directors and have appointed an independent chair have experienced relatively modest costs in doing so.

A. Independent Chair Survey Results

As detailed in the attached appendix, the Forum surveyed its members to gain first-hand knowledge about actual costs incurred by fund groups in connection with the corporate governance reforms contained in the proposed rules. Eighty-four percent of the fund groups that participated in the study currently have an independent chair. In each group, the chair has either been independent since the inception of the fund or the independent chair was a member of the board prior to becoming the chair. Electing a sitting board member as chair reduced or eliminated many one-time costs associated with selecting an outsider for the position, such as proxy costs, search firm fees, and additional board or nominating committee meetings.

The survey showed that additional compensation paid to the independent chair was the most common cost incurred in connection with the transition to an independent chair. The amount of the additional compensation varied greatly between funds, with some funds reporting that the independent chair received no additional compensation.

Fund groups also reported one-time legal expenses in connection with moving to an independent chair, including legal fees associated with reviewing the independent status of the chair under SEC regulations, disclosure review, and amendment of the fund bylaws and/or charter to reflect the independent chair. Survey respondents reported costs of less than $50,000 for each of these services.

The survey found more variation in annual legal expenses as a result of moving to an independent chair. As detailed in the survey results, some funds reported spending additional annual legal expenses of less than $50,000.

B. 75% Independent Director Requirement

A significant majority (90%) of survey respondents have a board composed of at least 75 percent independent directors. Those funds that rebalanced their boards to achieve 75 percent independent directors did so in various ways, with seven choosing to add new independent directors, five choosing to remove interested directors, and 10 choosing to do both.

As with the independent chair requirement, survey respondents reported both one-time and annual legal expenses in connection with moving to a board composed of at least 75 percent independent directors. The one-time expenses were incurred in connection with revising disclosure regarding the board composition and amending the fund's bylaws and charter to reflect the number of independent directors and were generally below $50,000 for each activity.

A number of fund groups also reported additional compensation expenses in connection with moving to a 75 percent independent director ratio. Several boards raised the compensation for the entire board at the time of rebalancing, with eight reporting additional compensation costs for new board members. Additional director compensation costs varied widely from fund group to fund group.

Respondents representing 51 of the Forum's 75 member groups of independent directors elected to participate in the survey. Our membership is sufficiently diverse that we believe that these results are typical of the fund industry as a whole.[10]

There is also no reason to believe that having an independent chair or a supermajority of independent directors will, by itself, raise fund costs by resulting in the hiring of additional consultants, lawyers or other service providers. The Commission has recently emphasized the authority of the board to hire consultants and other experts. Moreover, lawyers and consultants are almost always hired not because there is an independent board, but because the board feels it needs additional assistance or expertise in complying with its legal obligations. The costs of such service providers are thus more logically attributed to the regulatory provisions that prompt a board to seek assistance. (In addition, it is hardly a real "savings" to a fund if it fails to hire a consultant when needed, and thus potentially fails either to comply with its legal obligations or otherwise satisfy its fiduciary duties.) Finally, it is unlikely that an independent board, acting in the interests of fund shareholders, will hire an expert of any type unless it believes the likely benefits of doing so exceed the expected costs.

We also do not believe that there are any significant non-financial costs inherent in these governance enhancements. For example, some have argued that funds with an independent chair will lose the unique insights that an employee of the adviser can bring to board meetings. While we do not doubt that in many if not all instances interested directors can and do serve an important role on fund boards, those directors need not chair their funds in order to provide that value to shareholders.

IV. Other Impacts of the Commission's Proposed Governance Enhancements

As the Commission notes in its most recent request for comment, the Act requires the Commission not only to consider the costs of its actions, but also whether its actions "will promote efficiency, competition and capital formation." To the extent that the governance enhancements will have any effect in these areas, we believe that the effect will be beneficial.

Mutual funds play a key role in capital formation, for they are not only a significant vehicle through which Americans save and invest for their futures, but are also a key vehicle through which Americans' savings are channeled into the capital markets.

10 As of December 31, 2005, the 51 member groups participating in the survey reported assets under management ranging from approximately $500 million to $200 billion.

Their willingness to invest their savings in mutual funds can thus have an important impact on capital formation.

Americans' willingness to invest in mutual funds is obviously correlated to whether they believe that mutual funds are an effective and efficient means of investing. For example, if funds appear to be an overly expensive means of investing, or if the fund industry is viewed as being rife with conflicts and enmeshed in scandal, Americans will be less likely to invest in funds, and fewer dollars may ultimately flow through to the capital markets. The Commission's efforts to improve fund governance, combined with the fund industry's ongoing voluntary movement to adopt these enhancements as best practices appear to have increased American investors confidence in the fund industry. Compared to the period during and immediately after the fund scandals, flows of money into mutual funds have increased.[11] We do not believe it is coincidental that this has taken place while the Commission's governance reforms have begun to take hold and as there have been an increasing number of reports in the press regarding the increased effectiveness of independent directors.[12]

The effects of the governance requirements on efficiency and competition are perhaps less obvious and less notable. Still, it cannot be disputed that an engaged and effective board of directors controlling the costs of investing in funds and effectively overseeing the adviser's performance will make the funds more efficient and more competitive with respect to other investment vehicles.

V. Conclusion

In sum, it is the Forum's view that a fund governance system that includes an independent chair and a board with a supermajority of independent directors can be expected to provide substantial benefits to fund shareholders and to the capital markets generally, at a relatively minimal cost. Because of this balance of costs and benefits, there is good reason for the Commission to encourage further adoption of these enhancements by funds.

Our survey results indicate that 43 of the 51 member board participants have transitioned to an independent chair and 46 members to a 75 percent independent board. It is the consistent experience of these member fund boards that their shareholders have benefited from these decisions – put differently, their boards have presumably themselves weighed the costs and benefits of enhancing board independence, and have concluded that the benefits outweigh the costs. The Forum therefore encourages the Commission to

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11 *See, e.g., Investment Company Fact Book: A Review of Trends and Activity in the Investment Company Industry*, 46th Edition (2006).

12 *See, e.g.* Tom Lauricella, "Activism by Independent Directors Leads to Wincing, Lower Fees," *The Wall Street Journal*, July 5, 2006 at R1.

strongly reiterate, as it has done in the past, the value of these practices, and to encourage funds to consider adopting these practices as soon as practicable. [13]

Again, we appreciate the opportunity to provide these comments and the attached survey of our membership to the Commission to aid it in its continuing consideration of fund governance. We would be happy to address any questions raised by our comments and survey.

Sincerely,

Allan S. Mostoff
President

Attachment

cc: The Honorable Christopher Cox
The Honorable Paul S. Atkins
The Honorable Roel C. Campos
The Honorable Kathleen L. Casey
The Honorable Annette L. Nazareth
Mr. Andrew "Buddy" Donohue

13 The Forum recognizes that for some very small or new funds, these corporate governance enhancements may not be immediately feasible.

Appendix

AUGUST 2006 REPORT ON THE COST IMPLICATIONS OF AN INDEPENDENT CHAIR AND 75 PERCENT INDEPENDENT BOARD

Following the most recent D.C. Circuit Court of Appeals decision striking down the governance rules requiring an independent chair and 75 percent independent board due to inadequacies in the Securities and Exchange Commission's ("Commission") rulemaking process, the Commission requested comment about funds' experiences regarding the costs of compliance with these rules.

This is the third time the Commission has requested comment on rules that were initially adopted in 2004. The Commission approved the rules again in 2005, following a remand of the matter to the Commission "to determine as best it can the economic implications of the rule." The subsequent lawsuit by the Chamber of Commerce of the United States resulted once again in the rules being struck down. In each case, the court has never questioned the Commission's conclusions about the benefits or even of the costs imposed by the rules. Rather, in each case, the court has identified inadequacies in the Commission's rulemaking process and thus remanded the rules to the Commission for further consideration.

The Mutual Fund Directors Forum ("Forum"), a non-profit membership group consisting solely of mutual fund independent directors, has twice surveyed its members to provide further information about the costs of the fund governance provisions. This report contains details of the Forum's second survey of its members designed to provide information regarding the costs of the transition to an independent chair and 75 percent independent board by those groups that already have chosen to move to this governance structure. The Forum's first survey, compiled in August 2005, was conducted by telephone. The current survey, completed in August 2006, expands on the original survey by requesting more specific information about costs related to the transition to an independent chair or 75 percent independent board and reflects written responses from the Forum's membership base. [1]

Fifty-one respondents, representing 68 percent of the Forum's 75 member groups participated in the survey. These respondents are representative of a cross-section of the mutual fund industry, with net assets ranging from approximately $500 million to $200 billion.

The survey results indicate that costs related to a transition to an independent chair or 75 percent independent board are negligible in relation to fund assets or other far more significant costs such as fund advisory fees. Additionally, it should be noted that many of the transition costs incurred are one-time costs that will not have an impact on a fund following the year of transition.

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1 A copy of the survey is attached to this report.

Independent Chair

Current Status

Forty-three of 51 member groups responding to the survey reported having an independent chair. Eight member groups reported having an independent chair since the inception of the fund, 31 have had one for more than one year and four have had one for less than one year. In all cases where member groups have elected an independent chair after a fund's inception, the independent chair had been a member of the board.

One-Time Costs

Legal

Several respondents reported one-time costs in connection with the transition to an independent chair. One-time legal expenses were the predominant one-time cost reported by survey respondents. Eleven, 12, and 10 respondents reported one-time legal expenses of less than $50,000 for review of a chair's independent status, disclosure review regarding new board composition and by-law and charter amendments, respectively.

Other One-Time Costs

Two respondents also reported costs of less than $50,000 for hiring a search firm or consultant and four respondents reported costs of less than $50,000 for additional board or nominating committee meetings. Additionally, one respondent reported proxy related expenses of less than $50,000. Eight member groups also reported one-time professional development and education costs of less than $50,000.

Annual Costs

Compensation

Compensation was the primary annual cost incurred in connection with the transition to an independent chair. Expenses resulting from increased compensation to additional board members were reported by two respondents, with one reporting expenses of less than $50,000 and one reporting expenses of between $50,000 and $150,000. Twenty-nine member groups reported recurring expenses in connection with increased compensation paid to the independent chair.

Number of Respondents	Compensation Costs
18	Less than $50,000
8	$50,000 - $150,000
4	$150,000 - $500,000

Other Recurring Costs

In addition to compensation costs, several survey respondents also reported other annual expenses in connection with the transition to an independent chair. One respondent reported additional staffing costs of less than $50,000 to support the independent chair.

One participant reported an increase in insurance premiums of less than $50,000 following the transition.

Survey respondents also reported additional annual legal expenses in connection with the independent chair, with four reporting expenses of less than $50,000. One reported expenses of more than $500,000, indicating that the expenses were for additional staff to support the Board.

Finally, eight participants reported additional annual professional development and education expenses of less than $50,000.

75 Percent Independent Board

Current Status

Ninety percent of the survey respondents reported having boards composed of at least 75 percent independent directors. Seventeen participants reported a 75 percent independent board since inception of the fund, 27 for more than one year and two for less than one year.

Of boards that rebalanced to achieve a 75 percent independent board, seven reported adding new independent directors, five reported removing interested directors, and 11 reported both removing interested directors and adding new independent directors.

All respondents reporting that independent directors were removed from the board also reported that the former interested director was still employed with the management company and continued to participate in board meetings in a different capacity.

One-Time Costs

Legal Costs

A number of respondents reported incurring one-time costs in connection with the board rebalancing. Legal expenses were the one-time expenses most often incurred by respondents. Ten member groups reported legal expenses of less than $50,000 to review the independent status of a director, nine reported expenses of less than $50,000 to revise disclosure regarding board composition, and six reported one-time legal expenses of less than $50,000 to amend the by-laws or charters of the fund.

Other One-Time Costs

In addition to legal expenses, two respondents reported expenses of less than $50,000 and one respondent reported expenses of between $50,000 and $150,000 in connection with hiring a search firm or consultant and eight incurred expenses of less than $50,000 for additional board or nominating committee meetings.

Seven respondents also incurred expenses associated with proxy costs.

Number of Respondents	Proxy Costs
4	Less than $50,000
2	$150,000 - $500,000
1	More than $500,000

Annual Costs

Professional Development

The most frequently reported annual cost resulting from board rebalancing is the cost of directors' professional development and education.

Number of Respondents	Professional Development Costs
5	Less than $10,000
3	$10,000 - $25,000
5	More than $25,000

Compensation

After director professional development, compensation costs were the most frequently reported costs by survey respondents. Member groups reported two types of additional compensation costs in connection with board rebalancing: compensation paid to additional board members and an increase in compensation paid to existing board members.

Number of Respondents	Compensation Costs Additional Board Members
2	Less than $50,000
4	$50,000 - $150,000
3	$150,000 - $500,000
0	More than $500,000

Number of Respondents	Compensation Costs Existing Board Members
3	Less than $50,000
2	$50,000 - $150,000
1	$150,000 - $500,000
3	More than $500,000

Annual Legal Expenses

In addition to the one-time legal expenses discussed above, participants also reported an increase in annual legal expenses as a result of the board rebalancing.

Number of Respondents	Recurring Legal Costs
2	Less than $50,000
1	$50,000 - $150,000
1	$150,000 - $500,000

Other Recurring Costs

One respondent reported additional expenses of between $150,000 and $500,000 and one reported additional expenses of more than $500,000 for additional staff to support the board members.

Finally, one participant reported additional expenses of less than $50,000 as a result of increased insurance premiums.

Small Funds

In the case of a small fund complex, the impact of the costs of regulation may be magnified. The information below provides detail regarding responses from small fund survey participants, defined for this purpose as those fund complexes with less than $5 billion in assets.

Ten survey respondents reported having assets of less than $5 billion as of December 31, 2005. Of this group, eight have an independent chair and eight have a board composed of at least 75 percent independent directors.

Of those groups with an independent chair, five moved to an independent chair after the inception of the fund. In each of these cases, the primary expense reported in the transition to an independent chair was additional compensation of less than $50,000 per year paid to the independent chair. Other costs incurred by one small fund respondent included one-time costs of less than $50,000 for each of the following: a search firm or consultant, by-law and charter amendments, and professional development and education. Two small fund participants reported one-time legal expenses of less than \$50,000 to revise disclosure regarding board composition. Additionally, two respondents reported additional annual legal costs of less than \$50,000 and one reported annual professional development costs of less than \$50,000. In each case, the respondents reported that the transition had gone well and did not identify any detriments to having an independent chair.

Of the eight small fund groups that reported having a board comprised of at least 75 percent independent directors, five reported having that board composition since inception of the funds. Of those reporting a transition to a 75 percent independent board, one reported incurring no costs. One participant reported one-time costs of less than \$50,000 for the following items associated with the transition to a 75 percent independent board: additional board and nominating committee meetings, legal expenses related to the review of independent status; amending the by-laws to reflect the number of independent directors and professional development and education. Two participants reported increases of less than \$50,000 annually for compensation paid to new board members. Additionally, one small fund respondent reported annual increases of between \$50,000 to \$150,000 for compensation paid to board members and between \$150,000 and \$500,000 for legal expenses. Finally, one participant reported additional annual professional development and education expenses of between \$10,000 and \$25,000.

Other Information

In addition to the cost data outlined above, the survey requested additional information regarding the participants' experiences with the transition to an independent chair. Those groups having an independent chair generally have had positive experiences. Specific benefits of having an independent chair most frequently cited were more direct input into meeting agendas and enhanced ability of the independent directors to control the tone and content of board meetings.

Survey participants also identified a number of other positive benefits of an independent chair in their complexes. More effective communication between the board and management was frequently cited as an improvement associated with an independent chair. Several participants identified advanced notice of issues that would be brought before the board as a benefit of the independent chair. Additionally, one participant noted that one result was deeper dialogue with management about important issues.

Several respondents identified other benefits related to the independent directors' relationships with management. One respondent stated that an independent chair gave the board greater authority in its dealings with management. Another stated that management was more responsive to the independent directors than it had been under an interested chair. Additionally, several participants cited improvements to the contract renewal process because control of the process is vested in the independent directors.

Participants also identified shareholders as benefiting from independent chairs. One respondent stated that the independent chair is an important advocate for shareholders. Another noted that an independent chair can help balance the interests of management and the interests of shareholders. Another survey participant stated that conflicts can be more easily resolved in the shareholders' best interests with an independent chair.

Other benefits identified by respondents were related to the overall board responsibility. One participant reported an added level of confidence that the board is meeting its fiduciary responsibilities. Additionally, one participant noted an increased sense of responsibility on the part of other independent directors on the board.

Although the comments were generally positive, survey respondents did identify some detriments to the independent chair. The most common detriment identified by survey participants is the time commitment required of an independent chair. One respondent also was concerned about identifying qualified independent chair candidates. Additionally, one respondent reported difficulties in defining appropriate responsibilities for the independent chair.

Costs were also identified by one respondent as a negative effect of an independent chair, although that respondent noted that the costs for the particular group had been less than $10,000 per year. Another participant was concerned about the increased involvement and associated cost of counsel in the governance process.

Although communication issues were generally identified as a benefit of the independent chair, one respondent identified the additional coordination necessary between the independent chair and management as one difficulty in the transition to an independent chair. Additionally, one participant stated that there may be a greater potential for miscommunication or alternatively, the failure to communicate with management under an independent chair, especially on potentially important, time sensitive, or controversial issues.

Another participant noted that the former interested chair provided less input than before the transition. In contrast, because of the importance of a detailed understanding of the fund complex, one survey participant identified the necessity of management's continued involvement as an impediment to the effectiveness of an independent chair. Finally, one respondent expressed concern that an independent chair may negatively impact the adoption of new innovative business practices.

Conclusion

The overall experience of those survey respondents who have elected to have an independent chair and a board composed of 75 percent independent directors has been positive. As demonstrated above, the reported overall costs of an independent chair and 75 percent independent board are minimal, especially when viewed in comparison to funds' assets and advisory fees. Additionally, many of the expenses reported by survey participants are one-time expenses that will not be borne by shareholders on an ongoing basis.

BLANK SURVEY

Fund or Fund Complex ________________
Name of contact ________________

Mutual Fund Directors Forum
Member Survey
Impact of Recent Regulatory Initiatives Affecting Fund Boards

The responses to the survey will be collected and aggregated. Any report will not attribute the information to specific respondents or their funds, although the identities of all fund groups participating in the survey will be disclosed.

INDEPENDENT CHAIR

1. Does your board have an independent chair?
   __ Yes
   __ No
2. If the answer to question (1) is "yes," –
   a. How long has the chair been independent?
      ___ Since the fund's inception
      ___ More than one year
      ___ Less than one year
   b. Does the chair have a term limit?
      ___ Yes
      ___ No
   c. Does the chairmanship rotate?
      ___ Yes
      ___ No

3. If the answer to question (2)(a) is something other than "since inception"
   a. Was the independent chair a member of the board prior to becoming chairman? __ Yes ___ No
   b. Did the board have a lead independent director in the period before the chair became independent? __ Yes __ No
      i. If so, did the lead director become chair? __ Yes __ No

c. Were any of the following incurred as <u>one time costs</u> in connection with the change to an independent chair?

i. Costs associated with the recruitment process.

(1) Search Firm or Consultant

___ less than $50,000

___ $50,000-150,000

___ $150,000-500,000

___ more than $500,000

(2) Additional Board or Nominating Committee Meetings

___ less than $50,000

___ $50,000-150,000

___ $150,000-500,000

___ more than $500,000

___ None

ii. Investor communication and/or proxy costs (including expenses of proxy solicitation firms and legal counsel)

__ Yes (estimated total amount spent by the complex)

___ less than $50,000

___ $50,000-150,000

___ $150,000-500,000

___ more than $500,000

___ None

iii. Legal expenses

(1) Review of independent status (if new director)

___ Yes (estimated total amount spent by the complex)

___ less than $50,000

___ $50,000-150,000

___ $150,000-500,000

___ more than $500,000

(2) Revise disclosure regarding new board composition

___ Yes (estimated total amount spent by the complex)

___ less than $50,000

___$50,000-150,000

___$150,000-500,000

___more than $500,000

(3) Amend bylaws/charter to reflect independent chair

___ Yes (estimated total amount spent by the complex)

___ less than $50,000

___$50,000-150,000

___$150,000-500,000

___more than $500,000

___ None

iv. Professional development/education for the independent chair

___ Yes (estimated total amount spent by the complex)

___ less than $50,000

___$50,000-150,000

___$150,000-500,000

___more than $500,000

___ None

v. Other (please specify):

d. Are any of the following being incurred as <u>recurring costs</u> in connection with the change to an independent chair –

i. Compensation and/or benefits to additional board members

___Yes (estimated total amount spent by the complex annually)

___ less than $50,000

___$50,000-150,000

___$150,000-500,000

___more than $500,000

___ None

ii. Increase in compensation and/or benefits paid to chair

__ Yes (estimated total amount spent by the complex annually)

___ less than $50,000

___$50,000-150,000

___$150,000-500,000

___more than $500,000

___ None

iii. Additional staff to support the new chair

__ Yes (estimated total amount spent by the complex annually – include salary, benefits, training, office space, technical support and any other costs incurred in connection with the additional staff)

___ less than $50,000

___$50,000-150,000

___$150,000-500,000

___more than $500,000

__ None

iv. Increase in insurance premiums related to the independent chair

__ Yes (estimated total amount spent by the complex annually)

___ less than $50,000

___$50,000-150,000

___$150,000-500,000

___more than $500,000

__ None

v. Legal expenses

__ Yes (estimated total amount spent by the complex annually)

___ less than $50,000

___$50,000-150,000

___$150,000-500,000

___more than $500,000

__ None

vi. Professional development/education for the independent chair

__ Yes (estimated total amount spent by the complex annually)

___ less than $50,000

___$50,000-150,000

___$150,000-500,000

___more than $500,000

__ None

vii. Other (please specify):

SUPERMAJORITY INDEPENDENT DIRECTORS

4. How many directors serve on the board? ________

5. What proportion of the directors is independent?

___ less than 75%

___ more than 75%

6. If the answer to question (5) is 'more than 75%,' how long has the board been comprised of more than 75% independent directors?
   ___ since inception
   ___ less than one year
   ___ more than one year

7. If the answer to question (6) is other than 'since inception,'
   a. How was the rebalancing of the board accomplished?

      ___ Added new independent directors

      ___ Removed interested directors

      ___ Both (*i.e.,* replaced interested directors with independent directors)

   b. If interested directors were removed, is the interested director still an employee of the management company?

      ___Yes

      ___ No

      i If Yes, does the former interested director still participate in board meetings in a capacity other than as a member of the Board?

      ___Yes

      ___ No

      Describe the former interested director's role.

   c. Were any of the following incurred as <u>one time costs</u> in connection with rebalancing the board –

      i Costs associated with the recruitment process
      (1) Search Firm or Consultant
         ___ less than $50,000
         ___$50,000-150,000
         ___$150,000-500,000
         ___more than $500,000

(2) Additional Board or Nominating Committee Meetings

___ less than $50,000

___ $50,000-150,000

___ $150,000-500,000

___ more than $500,000

___ None

ii Investor communication and/or proxy costs (include costs of proxy solicitors as well as legal costs)

__ Yes (estimated total amount spent by the complex)

___ less than $50,000

___ $50,000-150,000

___ $150,000-500,000

___ more than $500,000

___ None

iii Legal expenses

(1) Review of independent status (if new director)

___ less than $50,000

___ $50,000-150,000

___ $150,000-500,000

___ more than $500,000

(2) Revise disclosure regarding new board composition

___ less than $50,000

___ $50,000-150,000

___ $150,000-500,000

___ more than $500,000

(3) Amend bylaws/charter to reflect number of independent directors (if applicable)

___ less than $50,000

___$50,000-150,000

___$150,000-500,000

___more than $500,000

___ None

ii Professional development/education

__ Yes (estimated total amount spent by the complex)

___ less than $50,000

___$50,000-150,000

___$150,000-500,000

___more than $500,000

___ None

iii Other (please specify):

b. Are any of the following being incurred as <u>recurring costs</u> in connection with rebalancing the board –

i Compensation and/or benefits to additional board members

__ Yes (estimated total amount spent by the complex annually)

___ less than $50,000

___$50,000-150,000

___$150,000-500,000

___more than $500,000

__ None

ii Increase in compensation and/or benefits paid to board members

__ Yes (estimated total amount spent by the complex annually)

___ less than $50,000

___$50,000-150,000

___$150,000-500,000

___more than $500,000

__ None

iii Additional staff to support the board members

__ Yes (estimated total amount spent by the complex annually)

___ less than $50,000

___$50,000-150,000

___$150,000-500,000

___more than $500,000

___ None

iv Increase in insurance premiums

__ Yes (estimated total amount spent by the complex annually)

___ less than $50,000

___$50,000-150,000

___$150,000-500,000

___more than $500,000

___ None

v Legal expenses

__ Yes (estimated total amount spent by the complex annually)

___ less than $50,000

___$50,000-150,000

___$150,000-500,000

___more than $500,000

___ None

vi Professional development/education

__ Yes (estimated total amount spent by the complex annually)

___ less than $10,000

___$10,000-25,000

___more than $25,000

___ None

vii Other (please specify)

STAFFING

In addition to the additional staff hired in connection with the transition to an independent chair and/or 75 percent independent directors, the questions below relate to other staff employed by the Board.

8. Apart from the CCO, does the Board also have its own staff?
   ___ Yes ___ No

9. If the answer to question (9) is "yes," aside from any costs related to the CCO, what do you estimate the total cost of the board's staff to be?
   $____________

COSTS

10. How are directors' compensation costs, staff costs, and other expenses allocated among funds?
11. What was the investment adviser's aggregate fee (in dollars) during the most recently completed fiscal year?
    - Aggregate: $_________
12. What is the estimated total of all board related costs and expenses for the most recently completed fiscal year?

Compensation:	$________________
Other:	$________________
Total:	$________________

IMPACT OF REGULATION ON POOL OF QUALIFIED CANDIDATES

13. Have any of your independent board members retired or resigned during the past two years?
    ___ Yes
    ___ No

14. If the answer to question 15 is "yes,"
    a. Did the board member(s) retire or resign as a result of changes in board size or composition?
       ___Yes
       ___ No
    b. Did the board member(s) retire or resign as a result of increasing regulatory burdens?
       ___ Yes
       ___ No

15. During the past two years, has it been difficult to identify and recruit qualified candidates to serve as independent board members
    a. To fill board positions (if any) that were created for purposes of rebalancing the relative proportion of independent and disinterested directors?
       ___ Yes
       ___ No
       ___ Not Applicable
    b. To replace board members who have retired or resigned?
       ___ Yes
       ___ No

Other

16. In your fund complex or cluster, on how many boards does each director serve? __________

17. What were the complex's aggregate net assets as of December 31, 2005?
    $____________________________

18. Approximately how many shareholders does your fund complex have?
    ____

19. The following questions are relevant to boards with independent chairs. If your board has an interested chair, please go to question 20.

a. Please describe how the independent chair is working.

b. Please describe any specific benefits that you see with an independent chair.

c. Please describe any specific detriments that you see with an independent chair.

d. Please describe any difficulties you have encountered during the transition to an independent chair.

20. The following questions are designed for boards with interested chairs.

   a. Do you anticipate transitioning to an independent chair? ___________

      i If so, when do you anticipate doing so?

      ____

   b. Have you begun making preparations to transition to an independent chair (*e.g.* determining who will be nominated)?

      ____

      ____

   c. Do you anticipate any difficulties or issues with the transition? If so, please describe.

      ____

      ____

      ____

      ____

      ____

      ____