Eric D. Roiter
Senior Vice President and General Counsel
Fidelity Management & Research Company
82 Devonshire Street
Boston, MA 02109-3614

August 21, 2006

Ms. Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Stree, N.E.
Washington, DC 20549

Re: File No. S7-03-04, Investment Company Governance, Release No. IC-227395 (the "Release")

Dear Ms. Morris:

I am writing on behalf of Fidelity Investments to offer our views on the Commission's invitation for public comment on the now-vacated provisions of the fund governance rules. This letter addresses the rules' provision that would have prohibited fund boards of directors (and independent directors on those boards) from electing a management director to serve as board chairman and would have required that in every case an independent director serve in that role. Fidelity had previously commented on the fund governance rules during the proposal stage.[1]

On April 7, 2006, the U.S. Court of Appeals for the District of Columbia Circuit unanimously ruled that the Commission had violated the Administrative Procedure Act when addressing the requirements of Section 2(c) of the Investment Company Act of 1940. That provision requires the agency to "consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation"[2] in any rulemaking under the 1940 Act. The court held that the Commission, in the wake of the court's earlier remand ruling,[3] violated the APA by relying on data outside the rulemaking record and by failing to afford the public adequate notice and an opportunity to comment on that data with regard to the cost and competitive implications of the governance rules.

The D.C. Circuit deferred for ninety days the issuance of its order to vacate the two challenged provisions of the fund governance rules, the "independent chairman" requirement and the 75% independent director requirement, to allow the Commission time to file a status report with the court. The Commission did so on June 13, 2006, concurrently with the issuance of the Release.

[1] Letter from Eric D. Roiter to Paul F. Roye, Director, Division of Investment Management (January 7, 2004); and letter from Eric D. Roiter to Jonathan G. Katz, Secretary, Securities and Exchange Commission (March 18, 2004).

[2] *Chamber of Commerce v. Securities and Exchange Commission,* 443 F. 3d 890 (D.C. Cir. 2006)

[3] *Chamber of Commerce v. Securities and Exchange Commission,* 412 F. 3d 133 (D.C. Cir. 2005)

In light of the absence of any request by the Commission to extend the deferral of its order, the court issued its order to vacate the two governance rules on July 20, 2006.

We have had an opportunity to review the comment letter submitted by the Investment Company Institute, dated August 21, 2006, and strongly concur in the ICI's position that the SEC should not resurrect the now-vacated independent chairman rule. In particular, we write to make these points:

(1) Fund boards, and their independent directors, should be free to exercise their business judgment in selecting the individual who they believe will best serve as board chairman, whether that individual happens to be an independent director or a management director – and fund investors should be free to choose among funds with management chairs and independent chairs;

(2) The Commission's objectives underlying the challenged fund governance rules have essentially been accomplished through other means. Even if any remaining purpose were yet to be served by new rulemaking, there are less intrusive ways the Commission could proceed – namely, by requiring that independent directors appoint a "lead independent director" or requiring that a fund's prospectus or other SEC-filed document disclose whether the board chair is a management director or independent director;

(3) The Commission should defer any new rulemaking initiative to re-impose an independent chair requirement. If at any point in the future the Commission were to start a new rulemaking proceeding, the agency should first avail itself of the results and recommendations of its General Counsel's "top-to-bottom" review, announced on June 13, 2006, on how the agency should comply with laws that require the Commission to conduct economic analyses of rule proposals.

I. Preserving Choice for Fund Boards and Investors

Fidelity has consistently urged that the Commission allow fund boards and their independent directors to exercise their informed business judgment in choosing a board chair. Given the many important decisions entrusted to fund boards – including annual decisions by the full board and by independent directors voting separately on whether and under what terms to renew a fund adviser's management contract – a fund board should also be entrusted with the authority to decide who, among all its directors, should serve as chair. This is especially so in light of the composition of the typical fund board, where independent directors constitute a supermajority.

Allowing a fund board to exercise the full range of its authority in this matter permits that board to take into account the particular circumstances, history and record of service provided by a given fund group. It is also in keeping with a governance model that places the highest importance on the role to be played by a board in the exercise of its collective business judgment. Commissioner Atkins succinctly noted in a recent speech that courts "will not second-guess judgments regarding business matters" made by a board of directors in good faith.[4] We respectfully

[4] Commissioner Paul S. Atkins, Speech before the International Corporate Governance Network 11th Annual Conference (July 6, 2006).

suggest that the Commission, with regard to the choice by a fund board of who will serve as its chair, should also recognize the importance of leaving these decisions to fund directors themselves. We note that a recent survey by the ICI indicates that many fund boards have, in fact, chosen to have an independent director serve as chair. According to the ICI, as of the end of 2005, approximately 52% of responding fund complexes have at least one fund board with an independent chair. The ICI survey comprised 185 fund complexes, representing about 88% of the fund industry's total net assets under management.[5]

In the same vein, fund investors should be free to choose among funds, weighing not only funds' investment polices, performance, expenses and services, but any other factors they deem relevant, including, if they deem it to be important, not only who serves on a fund board, but who serves as its chair. Investors' choices are implemented every day through decisions to purchase, hold or redeem fund shares. In response to the invitation in the Release for comment on "non-monetary" costs of imposing the fund governance rules, Fidelity respectfully suggests that the Commission, if it were to resurrect the independent chairman rule, would be exacting an undue and unnecessary "cost" from fund boards and fund investors – namely, the cost of limited choice.

II. <u>The Governance Rules' Objectives Have Largely Been Accomplished</u>

The Commission, in the course of its earlier rulemaking, emphasized that the fund governance rules were prompted by problems associated with late trading and market timing in the fund industry and that the rules were intended to improve the flow of information to fund boards and, more generally, to enhance board deliberations, particularly involving decision-making by independent directors. Fidelity respectfully submits that these objectives have largely been accomplished through other rules. These include:

- Rule 38a-1, which requires the appointment of a fund chief compliance officer directly accountable to a fund board, who must, among other things, report on all material compliance matters and on the operation of a fund's compliance policies and procedures;

- Rule 206(4)-7 under the Investment Advisers Act, requiring registered advisers to adopt written compliance policies and procedures and to appoint a chief compliance officer;

- Surviving provisions of the fund governance rules (Rule 0-1(a)(7)), which:

    - Require fund boards to conduct an annual evaluation of their performance, including a consideration of the effectiveness of their committee structures and the number of funds that they oversee;

    - Require independent directors, at least quarterly, to hold meetings without the presence of management directors;

    - Confirm that independent directors have authority to hire employees and retain advisers and experts necessary to carry out their duties;

[5] *See* Letter to Nancy M. Morris, Secretary, Securities and Exchange Commission from Elizabeth R. Krentzman, General Counsel, Investment Company Institute, dated August 21, 2006, at 3, n. 9.

- New rules requiring disclosure of funds' market timing policies and portfolio holdings disclosure policies;

- Rule 22c-2, which requires a fund board to decide whether a fund needs a redemption fee and requires the fund or its principal underwriter to enter into written agreements with omnibus recordkeepers to enable the fund to obtain information regarding trading activity within the omnibus account and to empower the fund to instruct the recordkeeper to restrict or prohibit further purchases by underlying shareholders; and

- New disclosure rules calling for detailed explanation of how the board evaluated specified factors in determining whether, and under what terms, to approve or renew a fund adviser's management contract under Section 15(c) of the 1940 Act. [6]

If the Commission believes that any further rulemaking is needed, other, less burdensome, alternatives are available. Chief among these would be a rule to require that, if a fund board chooses to have a management chair, the independent directors must select one of their own to serve as lead independent director. The Commission could require that fund boards adopt policies or procedures requiring that the lead independent director concur in board meeting times and meeting agendas, and have the ability to add matters to the agenda. In addition, the alternative long espoused by Commissioner Atkins and former Commissioner Glassman – to provide for disclosure by funds of whether a fund board chair is a management director or independent director – could readily be implemented, while preserving investor choice.

III. <u>The Commission Should Allow its General Counsel's Review to be Completed</u>

When issuing the Release on June 13, the Commission also issued a press release announcing that:

> "Chairman Cox has asked the Commission's General Counsel to conduct a top-to-bottom review of the Commission's process for complying with the National Securities Markets Improvement Act of 1996 and other laws that require an economic analysis of rule proposals. The purpose of the review is to ensure the Commission takes full advantage of the significant expertise of its professional staff – both in the operating divisions and in the Office of Economic Analysis – when preparing the legally mandated analysis of economic impact that must accompany proposed regulations."

The Commission is to be commended for undertaking this review. In light of the broad implications that the General Counsel's review has for all future rulemaking initiatives, we respectfully suggest that the Commission defer any future rulemaking regarding a fund board independent chair until the General Counsel has finished his work, delivered his report and recommendations to the Commissioners, and the Commissioners have had a full opportunity to review the report and to evaluate and then implement the recommendations made. This course seems particularly appropriate here, given that the immediate impetus for the review to be undertaken by the General Counsel arises from the shortcomings identified by the D.C. Circuit regarding the Commission's treatment of economic and competitive issues in the independent chair

[6] The Commission, of course, still has before it proposed amendments to Rule 22c-1, to implement a so-called "hard" 4 p.m. close.

rulemaking proceeding. We further suggest that the Commission, after receiving the General Counsel's report, consider inviting public comment on any significant changes that the agency is considering implementing as to how it will carry out analyses of competitive impact and other economic implications of future proposed rulemaking.

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Fidelity again expresses its appreciation for the Commission's invitation for public comment on the now-rescinded provisions of the fund governance rules. For the reasons we have discussed, we urge the Commission to defer any new rulemaking to re-impose an independent chair requirement, in recognition of the importance of preserving the full range of authority of a fund board to choose its chair and preserving a choice for investors to select funds based upon a wide range of factors including, if they deem it important, whether a fund's board is chaired by a management director or an independent director.

Sincerely,

Eric D. Roiter

Attachment

cc: Hon. Christopher Cox
Chairman, Securities and Exchange Commission

Hon. Paul S. Atkins
Commissioner

Hon. Roel C. Campos
Commissioner

Hon. Annette L. Nazareth
Commissioner

Hon. Kathleen L. Casey
Commissioner

Andrew Donohue
Director, Division of Investment Management

Brian Cartwright
General Counsel, Office of General Counsel