MUTUAL FUND DIRECTORS FORUM

"THE FORUM FOR FUND INDEPENDENT DIRECTORS"

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OFFICE OF THE SECRETARY

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

Re: File No. S7 03 04, "Investment Company Governance," Release No. IC 26323

Dear Mr. Katz:

The Mutual Fund Directors Forum ("Forum") is a nonprofit membership organization for independent directors of U.S. registered investment companies ("funds").[1] At the request of Chairman William Donaldson,[2] the Forum is developing a report, which we anticipate will be completed shortly, containing "recommended best practices" for independent directors of mutual funds in certain areas in which director oversight and decision making is critical for the protection of fund shareholders. The report will note that the recommended best practices are not legally mandated and may not necessarily be appropriate for every fund or fund family.

1. The Forum offers fund independent directors opportunities to discuss critical issues confronting fund investors, the funds and their directors. It seeks to promote vigilant, dedicated and well informed independent directors and to serve as their voice regarding important policy matters. The Forum's membership is limited to investment company independent directors.

2. Letter to David S. Ruder, Chairman, and Allan S. Mostoff, President, Mutual Fund Directors Forum, from William H. Donaldson, Chairman of the U.S. Securities and Exchange Commission (Nov. 17, 2003) and the Forum's response (December 23, 2003).

One of the Forum's recommended best practices will be that the chairman of a fund's board of directors should be an independent director. [3] Because of the importance of the Commission's independent chair proposal[4], we write to share with you at this time the Forum's conclusion, with the hope that this information will be useful in your consideration of that proposal.

An Independent Chair Would Enhance the Power of Independent Directors

The power of the board of an externally managed fund, no matter how independent, is constrained by their fund's structure. The Investment Company Act of 1940 ("1940 Act") deals with this unique organizational structure -- the provision of investment management and other necessary services by one or more separate entities through contractual arrangements. Because the officers and employees of the fund do not ordinarily perform these services, the 1940 Act requires the fund's directors to monitor carefully the relationships of the fund with its investment adviser and other external service providers. The term "watchdog" has been used by Congress, the courts and regulators to describe this responsibility, and particularly the role of fund independent directors.

The Commission has observed at various times that the 1940 Act's independence requirements need enhancement if independent directors are to serve their intended protective purposes.[5] Thus, in 2001 as a condition

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3. This view is supported by the Forum's Board of Directors and almost all members of its Steering Committee. The Steering Committee members are the independent directors whom each Forum member group has designated to act as liaison with the Forum. Members of the Forum's Board and the Forum's Steering Committee are participating in preparing the best practices report in their individual capacities, and not as representatives of their organizations, the fund boards on which they serve, or the funds with which they are associated. The Forum's recommendations with respect to all best practices will reflect the views of a majority of the Steering Committee members.

4 As set forth in "Investment Company Governance," Release No. IC-26323, January 15, 2004 ("2004 Release").

5. See, e.g. the 2004 Release and "Role of Independent Directors of Investment Companies," Release No. IC-24816 (Jan. 2, 2001) ("2001 Release").

to a fund's reliance on a variety of commonly used exemptive rules ("Exemptive Rules"), the Commission effectively increased the necessary percentage of independent directors from 40% to over 50% by adding a requirement that a majority of the fund's board be independent directors.[6] After the recent spate of fund industry scandals, the Commission proposed, in the 2004 Release, to enhance fund boards' independence by increasing to 75% the minimum proportion of independent directors required for funds to rely on the Exemptive Rules, and by requiring that the board's chairman be independent.

A fund's board should act independently on behalf of the fund and its shareholders in dealing with the fund's adviser and its other service providers. It will be the Forum's best practice recommendation that fund boards chaired by an independent director are better able to attain this objective.

Conflicts Presented by Having An Interested Chairman Would be Eliminated

The most important reason for fund boards to be led by an independent chairman is to eliminate conflicts presented by having an interested chairman. It is the board's responsibility to retain the investment adviser, monitor its activities and consider the terms of the advisory contract renewal. Although the independent directors must separately deal with these issues, if they are to be truly empowered to evaluate and approve contracts on behalf of the fund and to monitor objectively the performance of the investment adviser and all other fund service providers, the independent directors should not be led in that function by an employee of the investment adviser or other service providers.

The Authority of the Independent Directors Would be Enhanced

It is difficult for independent directors, who are by definition not directly involved in the operations of a fund's principal service providers, to be thoroughly informed about potentially material, but obscure details of those operations. The inside chairman's considerable advantage in terms of access to information and hands on fund experience can be significantly intimidating to independent directors. Entrusting the responsibility of board leadership to an independent director would underscore the legitimate authority and functions of independent directors.

6. See, 2001 Release.

When the fund's chairman is affiliated with its investment adviser, the implication is that the businesses of the adviser and the fund are and should be conducted as a single unit. With an independent director as chairman, the independent directors are better able to deal with fund management as a service provider reporting to the fund's board. Through an independent chairman, the independent directors can control meeting agendas, the tone and tempo of board meetings, the topics discussed, the amount of time spent on each topic, and the order in which topics are addressed. Without this degree of authority, independent directors may find it difficult to deal with an investment adviser who already is in a position to dominate the board through its substantial informational and administrative advantages.

Funds Will Not be Deprived of Management's Expertise

We are convinced that an independent director chairman can have a significant salutary effect on the way investment company boards function. The Forum's recommendation, however, will not be intended to imply that the independent chairman's duties will include supervision of the fund's day to day operations, or that the fund will be deprived of management's expertise. If an independent director serves as board chairman, representatives of management would continue to be responsible for a fund's day to day operations, would continue to be eligible to serve as fund directors and, in any event, would continue to be present at -- and fully participate in -- board meetings.

As we noted at the outset, the recommendation that the board chairman of a mutual fund be independent will be contained in the Forum's best practices report to be delivered shortly to the Commission.

Sincerely yours,

David S. Ruder

David S. Ruder
Chairman

Allan S. Mostoff
President

cc: Hon. William H. Donaldson
Commissioner Paul S. Atkins
Commissioner Cynthia A. Glassman
Commissioner Harvey J. Goldschmid
Commissioner Roel C. Campos
Paul F. Roye, Director, Division of Investment Management