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Board Governance Services, Inc.

505 South Flagler Drive, Suite 1450
West Palm Beach, FL 33401
Tel: (561) 835-8395
Fax: (561) 835-8508
E-mail: bgs@boardgov.com

S7-03-04

February 26, 2004

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Mr. William H. Donaldson
Chairman
US Securities and Exchange Commission
450 Fifth Street NW
Washington, DC 20549

Dear Chairman Donaldson,

You may find the enclosed cover letter and white paper on the challenges facing mutual fund directors to be relevant. We have sent it to a cross section of independent directors. Some of these directors also received a copy of *Putting Investors First: Real Solutions for Better Corporate* Governance, which I sent to you previously.

At the risk of requiring your indulgence, I have two questions:

Question 1: Independent mutual fund directors have an impossible job. As trustees of funds they are responsible to fund holders. As directors of the mutual fund management company they are responsible to its shareholders. It is virtually impossible to balance these two roles. Independent directors of the management company and of the funds should be different. Why does the SEC tolerate this obvious conflict?

Question 2: Under your leadership, the SEC has wisely noted that attorneys general and the SEC should not dictate fee levels or otherwise be in the business of "management or policy making." In a non-monopolistic structure, one would expect the market system to set fees, boards to set and oversee policy, and management to execute it. The markets should provide an optimizing discipline to these processes. This is beginning to work, as assets flow from troubled funds to "cleaner" ones. Over time the shareholders of mismanaged management companies and the fund holders who invested in their funds will pay a price for lapses. The problem is that the public understands that directors who were supposed to be fiduciaries have not been held accountable. Why isn't the SEC banning dozens of directors from future service for extended periods of time? Instead of legislating guidelines on how to do the job, why not ban those who clearly have failed? Those that remain will figure out how to do the job more effectively.

Sincerely,

Scott

Scott C. Newquist
President and CEO

SCN/sde
Enclosures

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February 26, 2004

Mr. XXXX
Director and Fund Trustee
XXXX Management Company
Xxxxx, NY 10021

Dear Mr. Mutual Fund Director:

Mutual fund boards, and especially their independent directors, have always had an extremely complex and time-consuming responsibility. Looming regulation in response to systemic, widely publicized (but not universal) problems threatens to make the job even harder. With regard to the issue/judgment/decision process, directors must weigh the impact of their decisions on the welfare and behavior of many constituents. Complicating matters, their decision-making balancing act must be performed in the face of uncertainty, a universal condition in both the investment and governance processes. Case law provides directors little guidance, because until now there have been few "on point" lawsuits challenging the performance of mutual fund directors. The result is that there is a dearth of road-tested guidance. As expectations and regulations change, many of the issues that boards and regulators will face have yet to surface and be addressed. Continuing case law and regulatory evolution is inevitable. Directors are at significant personal risk, and most are unaware of the extent to which they are exposed.

Many directors hope and believe that compliance with new regulations which set minimum standards and the adoption of new best practices will once and for all put the governance crisis in the past. The history of corporate governance reform, characterized by new rounds of legislation every few years, suggests that this is a naïve perspective. Compliance with the regulations of the day is a poor proxy for independence and diligence which provide real protection to directors. The conflict inherent in the structure of fund oversight which forces directors to shoulder/balance conflicting fiduciary responsibilities (to fund holders and to management company stockholders) remains. After all, the management company's revenues are the fund holders' expenses (fees).

The business judgment rule offers directors a powerful principle to protect them from reputational and financial risk. It must be preserved, but its protection has been widely abused as the requirements of diligence and loyalty have been diluted. Directors often overlook the fact that to rely on the business judgment rule, they must meet accepted standards of loyalty, care, and good faith. In short, directors must earn the right to rely on this rule every time they make a decision. The more conflicts they have, the harder it is to earn that right. What is "acceptable" is a function of the expectations of investors, regulators, shareholders and managers. The court of public opinion and capital markets driven prices are leading indicators of new expectations that drive new definitions of acceptability. Failure to comply with these enforcement systems result in far greater penalties than failure to comply with regulations.

Law and regulation are reactive by nature. Even the Delaware Chancellery Court, which has historically offered very broad latitude in meeting business judgment rule requirements, is recognizing that their latitude has resulted in abuse. As always, when standards change, the courts will judge directors for past acts based on contemporaneous, new standards. The illegality of short term trading, soft dollar payments, 12b-1 fees, the level of transparency regarding revenue sharing, and the sudden claim that mutual fund independent director's fiduciary obligation to fund holders supercedes, in all instances, their fiduciary obligation to management company stockholders are examples of this fact. Trying to get ahead and stay ahead of the governance expectation curve is both critical and difficult. It will require new approaches.

The attached paper identifies the mutual fund industry's principle challenges and recommends specific tactical responses that boards of directors should consider. Furthermore, it suggests how Board Governance Services, Inc ("BGS") can best assist boards in this regard, providing services and value that lawyers and other advisors do not provide (see Appendix I). BGS is uniquely staffed by experts in finance, governance, enterprise risk management and organizational design and behavior. Its staff has a clear and experienced perspective of the risks, opportunities, strategic challenges, and potential solutions to issues that continually arise in your industry. BGS focuses on issues that fall exclusively within the purview of boards of directors of companies, mutual funds and other organizations. As a result, it is positioned to provide transparently independent and unbiased advice and support to boards. Restated, BGS' only mission is to act as an independent resource for boards of directors.

There is no question that the tasks summarized in our paper will require significant increases in the time required of directors and the resources made available to them. Because independent directors have limited amounts of time to devote to fund oversight, BGS has positioned itself to provide the outside resources and support needed to help directors meet evolving fiduciary expectations. BGS possesses the resources and experience to ensure that boards exercise adequate diligence while maintaining a constructive relationship with management. Management, management companies, and their shareholders will benefit as trust and confidence in the board is restored.

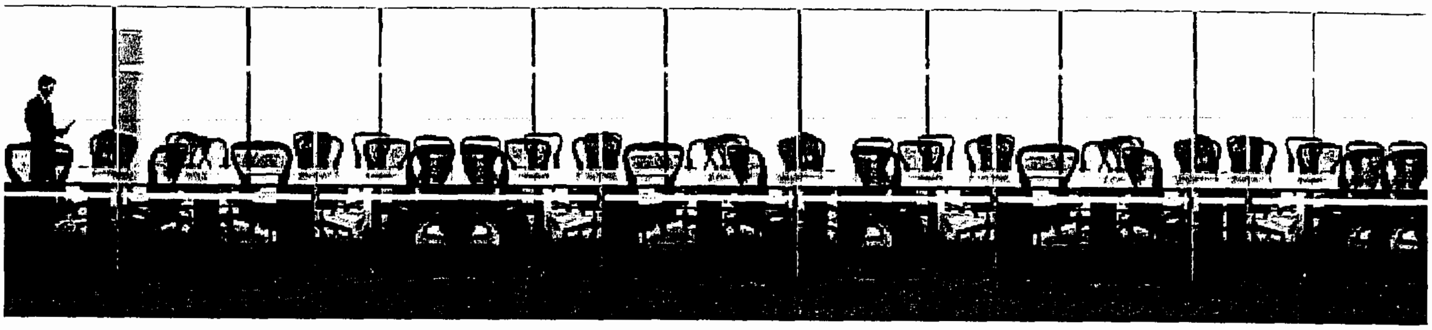
You can learn more about the services provided by BGS by visiting our website at www.boardgov.com

Sincerely,

Scott C. Newquist
President and CEO

SCN/sde
Enclosure

BOARD GOVERNANCE SERVICES, INC.



MUTUAL FUND BOARDS

EXPECTATIONS AND CHALLENGES

EXPECTATIONS AND CHALLENGES

Serving as a director of a mutual fund management company and simultaneously as a trustee of its individual mutual funds is a daunting challenge. The capital market system functions by replacing those who try but fail to meet challenges. Those who are perceived to not even try are penalized more severely. Undoubtedly some directors, fund trustees and boards have risen to the challenges of their complex fiduciary obligations. Many others are not meeting the current expectations of investors and fund holders. Admit it or not, like it or not, there is a widespread belief among investors, fund holders and regulators that many trustees have not met reasonable duty of care and duty of loyalty standards and that boards have not provided effective oversight or valuable guidance. Board Governance Services ("BGS") believes that in the absence of very different behavior by trustees and boards to meet evolving expectations, directors will begin to be penalized by loss of reputation and possibly by personal financial loss.

This paper sets forth the evolving expectations of investors and the resulting key challenges faced by directors. Appendix I enumerates the need-specific services that BGS provides to boards and their directors and trustees. Boards are our only clients. Helping directors and boards to meet their fiduciary challenges of diligence and loyalty provides directors and trustees with the best protection for themselves and the investors they represent. We encourage directors and trustees to consider the content and conclusions of this paper carefully.

I. DIRECTORS' INDEPENDENCE

The primary focus of new regulation has been independence, a proxy for duty of loyalty, and one of the two principle legs supporting the business judgment rule. The proposed requirement that three-quarters of mutual fund directors be independent of management is intended to assure that directors will make decisions with only the interests of the fund holders in mind. While the objective is universally laudable, the method of measuring and defining true independence is still evolving. Critics recognize that the simple "no ties to management" criteria fails to ensure real independence when the interests of a large, unknown group of fund holders is weighed against the interests of individuals with whom one has frequent interaction and are often responsible for directorship appointments.

In fact, real independence is a state-of-mind. Relying on a list of independence qualifications is flawed practice. A "one size fits all" list cannot reliably provide an intelligent approach to balancing the need to attract qualified directors and optimize independence. The result is that no check list is static. It is a moving target which forces independence to be judged after the fact based on contemporaneous standards. The current Oracle litigation being considered in Delaware, which posits that, the definition of independence is not satisfied solely by compliance with guidelines is a good example of the false security offered by compliance.

The relevant task for boards is to specifically define independence qualifications for their board and its committees (and maintain a currency of those definitions as events evolve and circumstances dictate). Each director should continually assess his/her own behavior and the board must assess whether as a group and individually they are meeting standards of independent behavior that protect fund holders and shareholders. Ensuring compliance with boilerplate independence guidelines does not fulfill the board's responsibility.

Just as speed limits set the maximum speed allowable for a motorist "when conditions permit," directors are obligated to use judgment with regard to independence. Directors who establish a company specific code of independence and periodically deviate from it in response to an outside influence should report their actions and the reasons therefore to each of their constituents.

II. STRUCTURE, ROLES, RESPONSIBILITIES, AND OBJECTIVES

Being a director is very similar to playing a team sport. The board makes decisions and is liable and accountable as an organization, just as a team wins or loses based on the combined performance of all players working as a team. Both star players on sports teams and particularly effective, insightful or ethical directors on boards can have a huge impact on team performance and earn personal notoriety, but the team's record is what counts. Performance is a function of team work...organization, coordination, specialization, and effort.

Directors universally posit that management is responsible for managing and that they are responsible for policy and oversight. This is appropriate with respect to the company. However, for a board to be independent of management, independent directors must be responsible for managing the board as an organization. The ability to act independently and meet oversight responsibilities with respect to the company is inexorably tied to effective board self-management and diligence discussed in the next sections.

Until recent settlements mandated new board structures and practices, mutual fund boards seldom thought of themselves as organizations with specific responsibilities, requiring objectives and measures of performance by which accountability and success would be judged by fund holders. Rather, directors thought of themselves as a group of individuals. Perhaps they divided up the work to save time, but specialization and organization were limited to establishing a subset of mutual fund boards because of legal necessity.

The line between the management company and the board, while recognized in principle, was blurred in reality. As a result, the board often deferred to the management company on issues for which the board held ultimate accountability. BGS does not believe that directors have consciously abdicated their responsibility. Rather, the issue has been a lack of structure and clarity of roles and responsibilities. Independent directors have not appreciated the distinction between their obligations to both fund management and company management. The result is that board information and decisions have closely mirrored that of management. It is no wonder that fund holders have lacked independent representation.

Times have changed. To avoid misunderstandings between (i) the board (and its various committees) and the management company, and (ii) between independent and non-independent directors, and (iii) independent directors who rely on each other for specialized skills or tasks, it is necessary to establish clearly defined and understood roles and responsibilities of individual directors, the board, its committees, and the management company. For each independent director to feel comfortable, he/she must have confidence that other directors are doing their job to support the team. However, directors do not have the ability to disavow responsibility for board actions just because they were not involved in the evaluative process for an action. Their responsibilities are joint and several in most instances.

Corporate boards, advised by legal counsel, have responded to over two years of scandals by writing and publishing committee charters that detail in varying degrees the board's and its committee's responsibilities. Their response to new expectations is instructive, disappointing, and provides a lesson in what not to do.

Some charters simply require boards to establish control systems but do not require them to assure that they are working. Many charters do not require boards to collect and analyze information not provided by management, despite the fact that asymmetrical information is central to influencing outcomes in our society. Several leading law firms are actually recommending this ambiguous approach and telling directors that they are protected by "checking the systems-in place" box. It is unlikely that shareholders (and ultimately the courts) view this as an effective risk mitigation strategy, although many directors have found it appealing from their personal perspective. This type of non-action has not escaped notice of plaintiff's attorneys, who will be quick to challenge the strategy.

Once the board has defined its responsibilities and objectives and committed them to writing, it will need to establish an organizational, procedural and staffing strategy to accomplish the job promised. Without real structure boards are likely to succumb to new pressures exacerbating inadequate oversight, greater confusion regarding responsibility, poor fiduciary representation, and increased personal risk for each director.

In order to honor their primary obligations of duty of care and duty of loyalty, boards need to devote all necessary time and to acquire the necessary resources to accomplish their established goals and objectives. Self-evaluations should then determine whether an adjustment of practices or the establishment of new controls is warranted. Without this process, compliance has not been demonstrated.

III. DUTY OF CARE

Duty of care is at least as critical to reliance on the business judgment rule as duty of loyalty, but it has received far less attention. With little to document, few boards have kept careful records of information gathering, independent analysis, discussion, debate, and the decision-making progress. Understandably, the courts have been reluctant to set guidelines to define duty of care. They have proffered that determining what information and analysis is required to make an informed decision is central to judgment, wise decision-making and authority. In short, they have not wanted to tell directors how to do their job. Reacting to egregious, albeit unintended in some instances, director negligence and the court's desire not to interfere with board authority, regulators have begun to define duty of care. Executive sessions, approvals of interim and year end statements, mandatory committees and the number of their meetings are examples. However, it is difficult to legislate minimum standards of diligence and effort before the fact. It is far easier to make judgments after the fact, the way the courts do.

In the context of the business judgment rule, director independence, discussed in Section I, provides the underlying incentive to fulfill duty of care responsibilities discussed in this section. Improved board structure and the acceptance of the organizational responsibilities discussed in Section II are required to allow the board of directors, as an entity, to act independently, to source material information, to analyze it, and to make studied decisions based on their findings. This duty of care section specifically discusses the directors' responsibility to proactively establish diligence as an objective of both the board and its individual directors. Furthermore, this section explains why duty of care is so central to directors' fiduciary responsibility.

Historically, many directors, absent a clear board policy, have taken a "we trust management" position regarding information made available to them by management. Today, fund holders expect that directors will assume a "trust but verify" attitude regarding management-supplied information. In addition, fund holders' expectations have risen to assume that a board will take the time and acquire the resources to collect needed information, analyze it, understand it, and be informed before they make decisions. If that were really happening, fund holder confidence would not be as eroded as it is.

The SEC clearly understands the need and importance of restoring the confidence of fund holders, and the courts are beginning to assert higher standards in corporate case law. The result is that independent directors are increasingly likely to be held to a new and more demanding standard requiring the use of all reasonable means to become informed. Across corporate America the defense of "plausible deniability" is being challenged and is no longer a reliable front-line defense. Ignorance of facts that could have been known by using reasonable care, including the use of outside resources that boards have the authority to employ, will not provide directors cover under the business judgment rule. Directors need to ask themselves if the board is informed and knowledgeable. If directors do not undergo this self-assessment, others will make their own assessments, with penalties.

Directors should be constructive cynics. They should consider that information provided by management might have been controlled and filtered to support self-interest. Spinning the story and diverting attention from inconvenient facts are not isolated one-time events in our society. The ability to influence the outcome of events is directly determined by information asymmetry. By the time children are three they have learned this lesson. The use of asymmetrical information is the foundation of negotiation, competitive advantage, winning votes in the democratic system, and leadership. Superior information management is a trait highly valued in executives, negotiators and politicians. To date the flow of information, or non-information, is mostly one-sided...from management to boards. Duty of care is about leveling the information playing field so that everyone is dealing with the same information.

In this context the issue of "trusting" is not personal. Should one trust? Certainly. You should trust people to do what seems best to them...for the company, for themselves, for their spouses and for their children. It is unrealistic to believe that an optimum balance of different groups' welfare will be consistently achieved, when the party which makes most of the decisions only provides information. A check and balance mechanism is required, and that is one of the board's central, but too often forgotten, purposes.

Not only must directors verify that the information they are receiving is accurate, they must also make an independent judgment that it is the right information for making the decisions they need to make. Asking the right questions is critical. Knowing what they are is not always easy and determining what they should be is very time consuming. As a result, regulators recognize that directors need help. Accessing independent outside resources to assist directors in fulfilling their duty of care obligations is now becoming a priority. For example, in late December, 2003 the National Association of Corporate Directors sponsored a Blue Ribbon Commission on Executive Compensation and the Role of the Compensation Committee. This commission recommended that boards hire compensation advisors that are not conflicted (they do no work for management) and provide boards with external, unbiased information, perspective and opinion. BGS, to its knowledge, is the only such company that presents itself exclusively as a resource for boards of directors, not management, not the fund holders, not the employees...not anyone other than the board.

IV. TRANSPARENCY

Transparency and disclosure are joint responsibilities of the management company and the board. Until now the content and format of disclosure were considered to be the exclusive purview of the management company...with unfortunate results. However, as fiduciaries for the stockholders and the fund holders, the board is ultimately accountable. It is the board's role to ensure that both constituencies have been told about and can reasonably understand the fund's governance and other policies, investment related parameters such as portfolio content and market valuations, and all fee and expense related issues including fees charges by the management company and paid by the fund holders.

The SEC has set forth new regulations requiring funds to provide certain disclosure documents aimed at both potential and existing fund holders. With these regulations now in place directors have a twofold obligation: (i) to carefully review management company practice to assure that these regulatory requirements are being met, and (ii) to satisfy themselves that the disclosures are complete and factual. There will inevitably be certain information that is not disclosed. Directors need to understand what it is and why it is not being disclosed to fund holders. Boards must constantly ask themselves which facts, policies, or practices are in place that have not been disclosed and which might impact a fund holder's investment decisions.

An example of withheld information is the standard policy of funds not disclosing portfolio investments on a real time basis. The popular argument that such disclosure would put fund performance at a competitive disadvantage is often cited and valid. The opposing point of view, assuming mutual fund ownership is one of multiple investment positions, would suggest that absent knowledge of a portfolio's make-up, a potential fund holder has no way of determining diversification. More sophisticated investors might want to hedge investments held in a fund with investments outside the fund. Without portfolio disclosure, their desired strategy is unattainable. Armed with information, fund holders could have the ability to significantly increase their welfare. This issue involves a difficult trade-off that directors must proactively evaluate and decide.

Full and easily understood disclosure of fees is another area of concern. Expectations with regard to fee disclosure will be increased by the continuing debate between the SEC and the New York Attorney General. In response to both behavioral and disclosure lapses, new maximum fee levels have been established for Alliance and others by the New York Attorney General. Although the SEC has taken the position that competitive markets and not an Attorney General should establish fees, it acknowledges that well-functioning competitive markets require far better fee disclosure than now exists. As a result, SEC pressure for greater transparency on all counts will increase, with the result being more stringent board accountability for full and unambiguous disclosure of fees and all other matters. BGS' principals, Messrs. Newquist and Eccles, have been at the forefront of the transparency movement, co-authoring books (The ValueReporting Revolution: Moving Beyond the Earnings Game, Building Public Trust: The Future of Corporate Reporting, and Putting Investors First: Real Solutions for Better Corporate Governance) which have been endorsed by other leaders in finance, regulation, and accounting.

BGS thinks it is likely that the dual roles of mutual fund directors as fiduciaries for fund holders and management company stockholders will have to result in a particularly high standard of disclosure in the mutual fund industry. This will evolve over time, demonstrating that regulators have lost confidence in boards to make reasonable judgments regarding the trade-offs involved in the decisions they are required to make. Confidence in the required balance of decisions by some mutual fund boards has already been lost, and the only way it can be restored is through fully transparent disclosure, so that each constituent can decide independently if their board has acted in good faith. Although improved or even absolute disclosure does not always protect the personal liability of directors and officers, disclosure thoroughness, accuracy, and timing may become a very important factor for mutual fund directors. As troubled mutual funds are identified and forced to disclose the real facts, the standards of disclosure for all companies will increase. It will certainly be worthwhile for even the best governed funds to plan for this possibility.

V. DIRECTORS AND OFFICERS INSURANCE

Like corporations, mutual funds and their management companies need to have comprehensive D&O insurance to attract and keep qualified directors and officers. As Hagglund, Weimer and Monteleone suggest in the forward to their book, D&O Directors and Officers Liability Guide to Risk Exposures and Coverage, "Perhaps no other insurance policy presents as complex an array of insurance, indemnification, corporate governance, tax and litigation issues."

The questions (among many others) that need to be asked concern (i) whether the terms and exclusions of the existing D&O policy reflect evolving standards of director responsibility and performance, (ii) whether the fund's directors have accessed independent and sophisticated advice regarding the adequacy of the coverage as it relates to their personal exposures, (iii) whether the cost of appropriate coverage falls within the defined parameters of a fund's risk management strategy (Note: a recent Financial Times article by Ellen Kelleher quoted a representative from the Willis Group who alleged that as a result of the widening investigation of the fund industry "premiums to protect mutual funds and executives against lawsuits have risen more than 300%," (iv) whether it is appropriate for fund holders to bear the cost of insurance for management company executives, and (v) whether there are any alternatives to standard D&O coverage?

BGS has particular expertise in D&O insurance and recognizes that two issues complicate D&O coverage and its pricing in the mutual fund industry. First, the industry has been self-insured through the ICI to a larger extent than most industries. In the face of the current crisis, the price of insurance will be elastic, and its availability inelastic...only some funds will be able to buy coverage...all funds will pay higher prices because of the problems of some. Second, for insurance to have value, damages for past problems must be paid. But there are ample legal grounds to refuse payment based on insufficient duty of care and loyalty. The solution for independent insurers is likely to be claim settlement coupled with much higher premiums going forward. While this solution may be fair for companies in trouble, it will penalize those whose premiums rise because of higher perceived industry risk for which they were not responsible. The only way to counter this problem is to differentiate good governance by demonstrating loss prevention policies and practices. BGS specializes in working with boards to persuade underwriters that governance risks of a particular board are materially less and differentiated from average risks based on existing or new policies and practices.

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There is no question that the tasks summarized above will require significant increases in the time required of directors and the resources made available to them. Because independent directors have limited amounts of time to devote to fund oversight, BGS has positioned itself to provide the outside resources and support needed to help directors meet evolving fiduciary expectations. BGS has the resources and experience to ensure that boards exercise adequate diligence while maintaining a constructive relationship with management. Management, management companies and their shareholders will benefit as trust and confidence in the board is restored. The Appendix summarizes the specific tasks required to protect fund holders and how BGS can assist the board in completing them regularly.

APPENDIX I

BGS SUPPORT SERVICES

"We approach our task with a view to establishing a board culture that reflects independence, transparency, knowledge and perspective."

I. INDEPENDENCE

- Design and update a fluid evaluative process that allows the board to meet or exceed current definitional standards for independence
    - Varying standards of independence are appropriate for the independent directors serving on the nominating, governance, compensation and audit committees
    - Minimum standards of independence are likely to be dictated by the SEC or Attorneys General and cannot be overlooked or ignored
    - More stringent standards influenced by circumstance will evolve because of media attention and/or decisions of the courts
- Provide the perspective of an independent point-of-view on board decisions before, they are approved, in order to assure board constituents that their presumption of a board-wide independent state of mind is warranted

II. STRUCTURE, ROLES, RESPONSIBILITIES, AND OBJECTIVES

- Facilitate board discussion/debate in defining its roles and responsibilities, incorporating input from:
    - Independent directors and their advisors
    - Legal counsels, representing the board and management
    - Executives of the management company
- Assist in establishing a director qualification/evaluation/selection process for the assignment of directors to committees
- Review all policies, practices and governance mechanisms determined to be within the purview of each committee
- Assist in establishing and documenting performance criteria and the self-evaluation process
- Work with the board to establish crisis-reactive policies and procedures
- The following are a representative sample of additional responsibilities that the board may decide it is obligated to assume, where BGS can provide valuable support:
    - Oversight of the accounting and financial reporting processes, including the selection and compensation of the principal auditing firm

    - Review of the company's major financial risk exposures and the strategies management has taken to address those exposures to protect fund holders
    - Review, amendment, and approval of management's compensation recommendations
    - Establishment of an independent search and succession processes for the board
    - Review and satisfaction that fund holders are protected and served by succession planning at the management company
    - Review of management company control and monitoring systems and procedures covering:
        - soft dollar payments
        - investment activities and trading by employees
        - compensation arrangements with sub-advisors
        - the appropriate levels of marketing (12b-1) expenses charged to investors
        - the accuracy and completeness of account statements provided to fund holders (including mark-to-market calculations)
        - the accuracy and completeness of press releases and other disclosures
        - unsolicited receipt, retention and treatment of complaints, including inside information by employees
    - Design of an orientation and fund-specific training process for new independent directors
    - Establishment of a reporting and communication format within the board and with the management company
    - Establishment of a loss prevention program for D&O liability
    - Routine completion of thoughtful board and committee self-evaluations and amendment of practices accordingly

III. DUTY OF CARE

BGS assists directors by providing issue-specific information and experience. It provides the resources and expertise to collect external information and to review, analyze and compare it to information provided by the management company, providing a system of checks and balances. At a minimum, a board must review management information systems at the management company level to be fully familiar with available information and its form. BGS will work with individual directors and the board as a whole to:

- Determine the depth and breadth of information that they feel is required to meet evolving legal standards of duty of care and that individual's self-standard as a fiduciary
- Present an accurate and complete overview of the information, such that informed decisions can be made
- Assist the board in determining what summary information it requires to regularly review

- Establish a policy of drilling down to analyze more detailed information on a periodic basis
- Develop a process to determine how to monitor and test for reasonableness and periodically determine if additional information would be useful
- Provide extensive preparation and financial analysis for scheduled meetings or other forms of board/management company interaction including the submission of appropriate agenda entries
- Create a mechanism through which the board can assess performance and value for fund holders and compare management company performance against that of its competitors
- Complete an objective competitive position analysis
- Review with the board how the fund oversight responsibility will be divided, delegated and assigned
- Develop a strategy whereby the board can effectively promote the best interests of the fund and its fund holders by providing consistent general direction for the management company
- Periodically review the effectiveness of policies, practices, procedures and strategies to "mark to market" the board's performance

Meeting this responsibility will entail a full and accurate understanding of (i) all regulatory requirements (State, SEC, ERISA), and (ii) pre-settlement and post-settlement fee structures and levels in every fund. BGS will oversee the design, installation and maintenance of a compliance assurance strategy. Specifically, BGS will:

- Establish procedures and systems that monitor compliance strategies and performance to:
    - ensure that the board <u>and</u> the management company have a current and clear understanding of all regulatory requirements and the timing of each
    - ensure up-to-date regulatory documentation
    - ensure that fund holders are charged the appropriate disclosed fee
    - ensure that fund holders are credited a mandated rebate (if applicable)
- Establish programs to detect and report on activities in violation (or potentially in violation) of federal/state statutes

IV. TRANSPARENCY

The board needs to clearly define and communicate to management the information it requires be made available to fund holders. It also needs to carefully establish a standard of presentation. In order to do this the board needs to enter into a cooperative dialogue with the management company regarding transparency. The management company must acknowledge that the ultimate decision on what should be disclosed (and how) is the board's responsibility, since it is the board that must balance the advantages and risks to fund holders and shareholders regarding what is disclosed. To these ends BGS will work with the board to:

- Determine an optimal level of transparency which maintains proper perspective between long-term results and short-term direction and performance
- Establish a common standard of transparency and disclosure for each fund in a family of funds
- Open and maintain constructive dialogues with regulatory authorities on governance objectives and initiatives to stay in front of change rather than react to it

V. DIRECTORS & OFFICERS INSURANCE

Traditional D&O brokers spend most of their time focusing on specific exposures and seeking coverage to close the risk gap. They spend virtually no time addressing the root of the problem, i.e. advising a company or fund on loss prevention strategies. BGS' greatest strength is that it specializes in assisting companies and their boards to improve governance practices, the activity at the core of loss prevention

- BGS focuses not only on the proper construction of the coverage, but on the internal policies and procedures which ameliorate risk and reduce premium
- BGS will assist the board in developing management guidelines to institute practices
- BGS will maintain a mindset that places a priority on predictive analysis and preventive practices, such that the fund demonstrates an understanding of the critical differentiation set forth by the United States Sentencing Commission in its Sentencing Guidelines which state that, "Culpability generally will be determined by the steps taken by the organization prior to an offense to prevent and detect [it]."
- BGS will communicate, explain, and promote the value of these guidelines to D&O underwriters to differentiate risk and reduce premium
- BGS will analyze alternative strategies to provide appropriate coverage, e.g., self-insurance and/or the creation of a captive
- The BGS focus will in all likelihood have a smoothing effect on premiums by positioning a fund as one with a proactive enterprise risk management mindset
- Before the negotiation of policy terms is finalized and coverage bound BGS will work with the board as a group and individually to make sure they have a thorough understanding of all of the policy's terms and conditions, their personal exposure, and the fund's exposures