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United States Senate

COMMITTEE ON APPROPRIATIONS
WASHINGTON, DC 20510–6025
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June 21, 2004

The Honorable William H. Donaldson
Chairman
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Dear Chairman Donaldson:

I understand that the Securities and Exchange Commission [SEC] intends to vote next week on an amendment to current SEC rules that would require the chairman of a mutual fund board to be an independent director. I am writing to register my objection to this proposed change. While I applaud you for your commitment to taking swift and aggressive action to protect investors in mutual funds, I must join several of my Senate colleagues in opposing the SEC on its approach on this particular issue.

The proposed change is based on the assumption that requiring chairmen to be independent would prevent the types of malfeasance that have occurred within the mutual fund industry in recent years. Yet there is currently no empirical evidence to support such an assumption. Many of the problems that we have seen occurred at companies that had independent chairmen. Additionally, there is no convincing evidence that funds chaired by disinterested directors perform better, have lower expenses, or have better compliance records than funds chaired by interested directors.

A much stronger argument is that interested chairmen are good for shareholders. The interested chairman, by definition, has a personal and professional stake in a fund's success. Often, the interested chairman's own money is invested and thus his or her financial interests directly tied to those of the shareholders. An interested chairman may have expertise and enthusiasm that few other individuals possess. Such a person would naturally have as his or her primary goal the performance of the fund which, not coincidentally, is the primary goal of the investor. I am concerned that by mandating highly-qualified, experienced directors to step down, you run the risk of actually hurting investors.

The proposed change also limits the field of candidates from which directors may choose their chairman. Directors should be able to select the chairman who is best-qualified and best-suited to the unique needs of the fund. The SEC is not better qualified than directors themselves to decide who should serve as chairman of a fund. Nearly all fund boards have at least a majority of independent directors. And many boards already choose to appoint independent chairmen.

Finally, in many instances, board actions must have the approval of a majority of the independent directors, in addition to a majority of the entire board. In short, to a significant degree, independence in mutual fund governance structures is already provided for, through a combination of existing rules and natural checks and balances.

Finally, the behavior of mutual fund boards and chairmen are in large part governed by market forces. Directors can vote out a chairman if he or she fails to deliver value to shareholders. Shareholders can express dissatisfaction by selling their stake in the fund. We saw this happen in 2003, when investors punished mutual funds by withdrawing their money in response to the late-trading and market-timing scandals. Such forces provide an incentive to chairmen to make decisions that earn a fund a reputation for low fees, high returns, and integrity.

You have taken on the momentous and unenviable task of restoring the American public's faith in mutual fund governance. I commend you for your efforts to increase transparency and accountability in the mutual fund industry, which is in the interest of all investors. As the Chairman of the Appropriations Subcommittee with oversight over SEC, I have supported you in these efforts unflinchingly. I will continue to do so, but I sincerely question whether the proposed change concerning independent chairmen truly would benefit investors. I urge you to reconsider this proposal.

Sincerely,

Judd Gregg

Judd Gregg
Chairman
Subcommittee on Commerce,
Justice, State, the Judiciary
and Related Agencies