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I am writing about proposals now under consideration by the SEC and Congress to improve the governance of mutual funds. Things clearly need to change, and on the whole, you are pushing us in good directions. The comments below convey both support and reservations.

The formalities of independence:

Board composition? The time to require at least 75% independent directors clearly has come, even though there is still a long road for many boards to go from "being" to acting independent. For the boards I am on, we long ago moved to have all directors but the chair (CEO for the advisor) be independent and to vest effective control of audits and nominations with the independent directors. But success does not rest in the degree of "purity" directors attest to in the long, annual SEC questionnaires. It remains in the area beyond the reach of regulations and periodic cross-checking, in the ethos that develops within a board and the reality of how directors actually behave.

I agree with keeping the required margin at something less than 100% because as long as the independent majority controls nominations, boards should not be banned from considering occasional "interested" but clearly investor and public-sensitive candidates. Over the years, I have worked with technically "interested" directors who were fully as sharp and tough in watching out for shareholders as anyone else on the board. Some of the earliest good research on board composition even argued the superiority of boards that included "insiders" -- people whose close-up understanding of an industry and of company operations can help outsiders learn to sense where changes likely are needed and how best to get them put into effect.

Generally, boards seem large enough. It complicates the task of finding strong new candidates and slows achievement of the 75% balance if boards respond to the mandate by trying to grow. It may take 2-3 years for a strong, independent nominating process really to take hold.

Who should be chairman? A requirement that the chairman of a fund must qualify as formally "independent" is one mandate too many. Proper protection for shareholder interests rests on a dual foundation – how both the lead manager within the advisory firm and the board understand, advocate, and act for those interests. Boards have the essential powers to keep internal managers in line by controlling nominations, taking significant responsibility vis-à-vis audits and compliance, and insisting on a part, and if necessary, the decision in setting agendas for their work together. What matters is not who is called "chairman" but whether the board as a whole asserts its powers with wisdom and courage.

Lead managers should be people who combine skill in running a business with the same sense of obligations to investors that independent directors are expected to feel. A lead manager chooses, develops, supervises, and if necessary disciplines or replaces portfolio managers and other staff and watches over the performance of third parties who provide services for a fund. The lead manager should have deep knowledge of operations and issues within the funds and of developments elsewhere in the industry that justify being given a significant input in setting agendas for board meetings. Increasingly with funds embedded in ever larger financial systems, boards need lead managers with guts and skill to advocate outward and upward in the corporate organization for the kind of stewardship that mutual fund investors deserve.

An effective lead manager, like the CEO of other kinds of corporations, merits the title and, for whatever extra measure of power it gives on the inside, the status of being chairman. If a lead manager who is chairman performs poorly, the title should not carry protection against being replaced. The title of "charman" for an independent board member does not fill the gap caused by inferior internal leadership unless we do what no one is proposing, to make that independent chairman and board member the day-to-day leader of the fund.

The funds with which I am currently involved are happy with roughly twenty years of experience of working through a liaison director (as was the best corporate board on which I have served). We considered the idea of an independent chair at a time of transition 2-3 years ago and specifically rejected the option. The liaison relationship over the years has allowed plenty of clout with management. Within the boards, the concept of lead director reinforces convictions about how directors should interact. Flatly rather than hierarchically linked, all of us have a sense of being in the "frying pan" together to consult and participate. There is no single voice with higher formal status behind whom other directors can hide.

Rather than mandate who gets the title of chairman, rule-making on your part and self-evaluation of performance on our part should focus on being sure that independent directors have and use their collective powers:

- To influence agendas and the conduct of meetings, and to critique how meetings can be improved.

- To critique the performance of the lead manager (whether or not the chairman) and as necessary to have influence over his or her development or replacement.

- In larger complexes, to work with the lead manager to influence attitudes, priorities, and decisions at higher levels of the organization, in order to insure a more healthful climate for operation and development of their mutual fund business.

- If performance and other circumstances dictate, to seek a new advisory relationship with some protection against scorched earth actions by current management.

If there is a case for making the chairman an independent director, it seems most compelling precisely in funds where it will be difficult to accomplish: e.g., funds organized by a headstrong entrepreneur or a well entrenched executive who has shortcomings in seeing shareholder interests and who has put most of the directors into their jobs. Putnam and Navellier are cases in point. Shifting titles around for such funds may accomplish very little unless other steps have been taken to assure strength and power for independent directors.

The other setting to consider more carefully is the frequent one today where fund boards and their advisors face challenges as parts of huge, diversified financial complexes. The primary job of a board is to keep their fund advisor on the straight-and-narrow. However, unless things settle down for the mutual fund industry soon, the issue for boards and lead managers within a complex is going to be less "who is chairman?" and more "how do board and advisor jointly influence people higher up?" If risks or violations are at the level of a fund complex as a whole, or even higher up in the financial conglomerate's structure, how does one of the boards look beyond acting for shareholders on its own toward communication and collaboration with boards for other funds in the complex?

More important than rules specifying an independent chairman would be rules that give the independent majority of a board clearer powers to influence who gets and who keeps the role of chief internal executive for their funds. Further, when critical issues reach to the top of a corporate complex, further thought should be given to how to encourage and empower direct communication between independent directors of funds and independent directors of the corporation as a whole.

If additional rules or guidelines make sense to counter entrenched entrepreneurs or wayward financial complexes, they should come after further study of how independently minded boards are trying to cope. Who carries the chairman's title seems unlikely to be part of the answer.

Achieving real independence:

Moving from formal to real independence is hard to achieve by rule setting. The steps suggested can help, but please frame the rules and the SEC tracking system so that time and expense to document they are being followed does not drain energy and creativity for living up to them in spirit.

<u>Annual self-assessment</u>? This is a good idea, but one which should be introduced with as few restrictions as possible about how it is done and some effort over time to gather evaluations of what approaches work best. Evaluation starts with a close look at a board's own action and experiences; but there is also a great need to help directors compare what they see within their own fund domains with best practices and problem areas in other fund settings. One of the most constructive outcomes of the current ferment about how well mutual funds are doing is the sudden blossoming of new ways to learn about and to learn from the experience of other boards. We don't need a questionnaire asking what we read or

how many continuing education units we have acquired in directors' seminars; but regulators, industry associations, information entrepreneurs, and boards can do a lot more together to create and to evaluate educational opportunities for directors.

I have no objection to the two required areas of questioning, but suggest that even the most self-critical board is not likely to be best at evaluating the number of boards on which its members should serve or the number of funds they should oversee. There is no simple, formulaic answer to such questions. It depends on the coherence of concerns and issues within the funds, the track record of the advisors in running funds in ways that pose few problems, and the capacity of individuals to carry and execute multiple responsibilities. The gut issue is whether each fund is getting its due in terms of time and talent. Boards supervising large numbers of funds have a hard time looking plausible as monitors of individual fund performance; but on auditing and managerial issues that have common threads in a complex across funds, being involved with many funds can be an advantage.

Ask boards to do the self-evaluation, but take time to do further research on what kinds of approaches make sense for different configurations of fund organization and management.

Separate sessions? This is a good idea, but take into account the variety of ways communication can occur. Beyond the annual contract review, we often do dinners the night before our quarterly board meetings; and an active tradition of e-mail exchanges between meetings has developed. Conference calls with our independent counsel – important to staying ahead of the curve in the last few months – are likely to become a periodic routine just to make sure we are keeping an eye out for emerging issues within our funds or across the industry.

Don't dismiss what regular communication with "interested" players about shareholder-sensitive issues can do. Our board meeting mornings start over breakfast with the chairman, fund counsel, and our independent counsel. These conversations let us raise concerns with the chairman as well as hear his views on what we need to work on. If we are succeeding, it is because we have tried to think through not only how independent directors share with one another but also how these discussions should interleave with communications with management.

Independent director staff? The value of independent counsel has become obvious even to the oblivious. Other options to add staffing can help, too. But staffing should not be required. Any moves a board makes should be evaluated, before and after, with respect to:

- Boundaries on responsibility – Think back to critiques and ultimately the rejection of Arthur Goldberg's proposals decades ago. It is often better to lean on management to be sure they have the analytic and investigative resources to reach good decisions in the first place and then to share their studies with the board than to have the board take over that work. Just as relevant analysis done within the advisory staff often does not reach the board, much of what a board staff produces may not reach advisory staff, either.

Transmitting the work of board to advisory staff in a dismissive way can undermine morale and sense of responsibility for self-evaluation and self-improvement.

- Flexibility – Match commitments to need – consultants or project hires to meet today's needs, yet keep the way open to hire others as needs change; and longer-term staff only when their talents are multifaceted and when continuity of involvement is important.

- Costs and benefits – With SEC and Congressional backing for more board staffing, you can be sure boards will be besieged by entrepreneurs to whom their own careers and bottom lines matter as much as good results for investors. The fees for extra staff and the costs in terms of pay to directors and employees of the advisor to work with them can add up quickly. Too often decisions to engage outside help are never evaluated afterwards to ask what benefits they produce. C. Northcote Parkinson is still a relevant authority.

Record keeping for approval of advisory contracts? It is not clear how this proposal is supposed to help. What do you expect it would have accomplished in catching late trading and market timing issues or in driving better presentations of cost data that we now seek for shareholders? Does the proposed six-year retention without assurance of confidentiality pertain to your hopes for taking enforcement action, your hopes that we will make our reviews more thorough, or your desire to do research on what funds do to derive future recommendations for "best practice"? The costs of this requirement sounds high, and its immunity against "gaming" by boards and counsel who want to cast a smoke-screen over short-cuts they have taken seems low.

We think we do a pretty through job in advisory reviews already, and we want to improve. Record keeping, however, has no bearing on my two highest priorities:

- How we do a better job at the annual review of including "blue-sky" discussion of ways in which we. the advisor, and the industry can go wrong. We need to keep pushing the envelope on how we probe for areas not yet clearly "on the screen" where internal practices, pressures, and incentives might work to the detriment of shareholders.

- We need as boards to know more about costs and profit margins for the advisor and significant third-party providers as a way of judging costs to shareholders on an absolute level rather than in comparison to other funds. These are very hard to untangle for single funds in an organization where almost everyone of significance works for multiple funds. We keep trying with management to develop more meaningful data and to work with management to find better frameworks for analysis and reporting. Improvements in how funds present data on costs to shareholders will mean more if the industry as a whole agrees on better and more uniform ways for complexes to attribute shared costs of staff and services to individual funds.

Personal background. For the record, rather than as a claim of any special expertise, I have been for roughly thirty years an independent director of three funds that started within Lehman and now rest within the Citigroup complex: the Salomon Brothers Investors Value Fund, the Salomon Brothers Capital Fund, and the closed-end Salomon Brothers Fund. My first contacts in being evaluated to join these boards were not with Lehman insiders, but with two very independent directors, Frances Reed and Bill Gossett. They made it clear by instructions and by example that directors work for shareholders, not for the advisor. We have tried not to waver since, through three major transitions in management company arrangements. Our boards already have implemented many of the practices you want to put in place.

My interest in governance issues has been enlarged by service on other corporate and fund boards, my years as dean of NYU's graduate business school and president of Babson College, and the experience of organizing and chairing the 1978 American Assembly on corporate governance. I come at my assignments, not as a lawyer nor regulator, but for better or worse through my own academic research and managerial assignments, as a long-time student of human behavior and organizational processes. Hopeful rush toward new regulations doesn't let us escape the reality that only the ones that truly reshape perceptions, attitudes, and incentives are worth pursuing.

Sincerely yours,

William R. Dill