NEW YORK CITY BAR

COMMITTEE ON INVESTMENT MANAGEMENT REGULATION

PHILIP L. KIRSTEIN
CHAIR
1345 AVENUE OF THE AMERICAS, FL. 17
NEW YORK, NY 10105
Phone: (212) 969-2108
Fax: (212) 969-2290
phil.kirstein@alliancebernstein.com

JOHN G. JEROW
SECRETARY
919 THIRD AVENUE
NEW YORK, NY 10022
Phone: (212) 756-2763
Fax: (212) 593-5955
john.jerow@srz.com

Mr. Andrew Donohue, Director
Division of Investment Management
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

December 20, 2007

Re: Recommendations with Regard to Reducing Unnecessary Burdens on Independent Directors

Dear Mr. Donohue,

The Committee on Investment Management Regulation of the New York City Bar (the "Committee") appreciates your recent invitation to comment on actions the Securities and Exchange Commission ("SEC") or the staff of the Division of Investment Management (the "Staff") might consider to alleviate unnecessary burdens on independent directors of investment companies registered under the Investment Company Act of 1940 (the "Act"). The Committee is composed of lawyers with diverse perspectives on investment management issues, including members of law firms, and counsel to financial services firms, investment company complexes and investment advisers. A list of our current members is attached as Annex A.

The last several years have witnessed many historic regulatory and enforcement developments in the fund area, and the SEC has emphasized in a number of rulemakings the important role played by independent directors of funds. In 2002 and 2004 the SEC adopted rule amendments that were intended to improve fund governance by requiring funds that rely on certain exemptive rules to comply with various requirements, including measures intended to empower independent directors such as the requirements that any counsel to the independent directors of a fund must be an "independent legal counsel" and that independent directors must meet at least once quarterly in a separate session at which no interested persons of the fund are present.[1] The SEC's adoption of Rule 38a-1[2] under the Act in 2003 was intended, in part, to "strengthen the hand of fund boards".[3] Rule 38a-1 assures independent directors access to a source of compliance information that is answerable to them by requiring the designation by the board (including a majority of the independent directors) of a chief compliance officer ("CCO") whose compensation must be approved by the board (including a majority of the independent directors), and who cannot be removed without the action of such persons. Rule 38a-1 requires the CCO to be responsible for implementing the fund's compliance program, and that the CCO must report at least annually to the board and meet at least annually with the independent directors.

These initiatives were part of a very significant number of rulemakings by the SEC in recent years affecting fund boards, many of them in response to the Sarbanes-Oxley Act of 2002 as well as market timing, late trading, directed brokerage and other issues affecting the fund industry. A large number of the new and revised regulations that resulted from these initiatives have involved additional duties for fund directors, particularly independent directors. In addition, SEC commissioners and members of the Staff have, in numerous speeches, repeatedly emphasized the importance and duties of independent fund directors. Encouraged by the SEC, organizations such as the Mutual Fund Directors Forum and the Independent Directors Council have issued reports and recommendations and suggested numerous best practices for the consideration of independent directors.

In response to the problems in the fund industry that surfaced in 2003 and the various developments noted above, fund directors across the country have not only undertaken the new

---

[1] Role of Independent Directors of Investment Companies; Investment Company Act Release No. 24816, January 2, 2001; Investment Company Governance, Investment Company Act Release No. 26323, January 15, 2004.

[2] Compliance Programs of Investment Companies and Investment Advisers, Investment Company Act Release No. IC-25925, February 5, 2003; Compliance Programs of Investment Companies and Investment Advisers, Investment Company Act Release No. IC-26299, December 17, 2003.

[3] Id.

duties resulting from the SEC's various rulemakings, but also have worked with fund advisers and administrators to improve fund governance (including the quality of meeting materials) and disclosures. It should be noted that these actions were taken on top of a robust slate of pre-existing duties. As has been widely reported, fund board meeting agendas and materials have expanded significantly in recent years, and board and board committee meetings have generally become much longer and more frequent.[4]

The Committee is aware that many fund directors believe that too much of their time at board meetings is spent on routine compliance work or making required findings that can only be made, as a practical matter, in reliance on representations by an expert third party such as the fund's adviser or administrator. The Committee believes that it is inappropriate to require directors to devote significant attention to these types of matters, and that this is not in the best interests of funds or their shareholders. We suggest that director effectiveness could be increased, and protection of shareholders enhanced, by permitting compliance monitoring and expert determination responsibilities to be undertaken by others (in the case of compliance monitoring, the CCO (a position that did not exist when these burdens were devised), and in the case of expert determinations, the adviser or some other person with the appropriate expert capability), thereby permitting directors to focus more of their attention on matters that they believe important in discharging their duties to the funds.

The Committee commends the Staff's interest in assisting independent directors perform their unique role by determining whether certain of their duties, acquired over time from numerous and, to some extent, uncoordinated sources, might be removed or made less burdensome so as to permit them to focus on the many important matters that call for their time and attention.

Outlined below are four[5] areas where the Committee suggests changes that would reduce unnecessary burdens on independent directors, thereby improving fund governance and

[4] See, e.g., "The board weights ever more heavily on members' backs" at page 21 of the Financial Times Weekly Review of the Fund Management Industry on December 3, 2007.

[5] The Committee, recognizing Rule 12b-1 is the subject of a comprehensive review by the Staff and the SEC in light of the extensive developments since the Rule's adoption, does not address possible amendments to this rule herein, but suggests that consideration be given to modifying the requirement of Rule 12b-1(b)(3)(ii) that fund directors

enhancing investor protections. The Committee would welcome the opportunity to work with the Staff on the implementation of any or all of these suggestions.

Elimination of Quarterly Review of Transactions Effected Pursuant to Certain Exemptive Rules

Independent directors have long had compliance oversight responsibilities with respect to transactions effected pursuant to certain exemptive rules under the Act; specifically, to determine no less frequently than quarterly that each transaction effected in reliance on Rules 10f-3 (purchases of securities in an underwriting in which an affiliated person is a participant), 17a-7 (trades between funds and certain affiliated persons managed by a common adviser), or 17e-1 (transactions using affiliated brokers) was effected in compliance with procedures adopted by the fund's board (including a majority of the independent directors) that are reasonably designed to comply with the requirements of the relevant rule. Boards normally fulfill this responsibility by receiving each quarter reports of each transaction effected in reliance of one of these rules in the prior quarter. In some fund groups there may be very few such transactions in a quarter, while in others there may be thousands.

The reports presented to directors to enable them to make the required findings under these rules necessarily include information designed to show compliance with each exemptive rule requirement, and determining compliance is a relatively mechanical exercise. Compliance personnel will have investigated transactions that appear to raise compliance issues in advance of the board meeting in order to be able to discuss such transactions with the directors and either explain why they are deemed compliant or, in the event of a violation of the procedures, the remedial action that has been taken or is proposed to be taken. The directors are heavily reliant on the adviser, the administrator or the CCO to capture the proper data, identify and investigate and report on potentially non-compliant transactions. Nonetheless, the rules require that the directors (including a majority of the independent directors) review each transaction and determine that it was effected in compliance with the fund's procedures. The Committee

receive and review, at least quarterly, written reports of the amounts expended under a plan and the purposes for which such expenditures were made. In many cases this requirement leads to routine and potentially lengthy reports that merely state that amounts computed at approved rates have been paid for the purposes previously authorized, and many directors question the value of such reports.

suggests that requiring independent directors to function as compliance analysts in this way is not an appropriate use of their time, and is not in the best interests of investors.

The Committee notes that these exemptive rules were adopted long before Rule 38a-1 provided fund directors with a CCO,[6] and that the procedures required by the rules (which normally are adopted at the time a fund is organized) form a part of the comprehensive compliance programs approved by the directors and administered by the fund CCO as required by Rule 38a-1. Directors and CCOs have invested substantial time and attention in implementing compliance programs since the adoption of Rule 38a-1. Consistent with Rule 38a-1, CCOs receive oversight and derivative authority from the independent directors, while independent directors rely on the CCO for reports on the implementation and updating of the compliance program.

Although Rule 38a-1(a)(4)(iii) requires that the CCO report to a fund's board and meet with the independent directors at least annually, the Committee believes that in practice most CCOs report to the board and the independent directors at least quarterly. The Committee believes that it would be reasonable and appropriate, and in the best interests of investors, for the SEC to adopt rule amendments to permit (but not require) directors to satisfy their quarterly review obligations under Rules 10f-3, 17a-7 and 17e-1 by receiving quarterly reports from the CCO on compliance with the funds' procedures relating to these rules in lieu of receiving reports on each individual transaction effected pursuant to the procedures and we recommend that the SEC amend these rules to permit this. The Committee further recommends that the SEC not specify the form of such reports so that directors can have the flexibility to design reporting that is appropriate for them, which may involve reporting on an exception basis. The Committee recognizes that not all Boards (or CCOs) may wish to proceed in this manner, and therefore, the Committee recommends that the SEC give directors the option to receive a quarterly report from the CCO in lieu of transaction reporting, as they see fit.

The Committee notes the cautionary observations concerning this type of approach raised in your November 6, 2007 Keynote Address at the Independent Directors Conference. You stated that there may be a danger of overburdening the recently created office

---

[6] Rules 10f-3, 17a-7 and 17e-1 were originally adopted in 1958, 1966, and 1979, respectively.

of CCO with responsibilities and questioned whether the CCO is the right person to shoulder a particular responsibility. The Committee notes that Rule 38a-1 already makes it the CCO's responsibility to administer all of a fund's compliance policies and procedures, including those adopted pursuant to exemptive rules. Administration necessarily involves being satisfied that the procedures are being complied with. With respect to whether or not the CCO is the right person to prepare and deliver the proposed compliance reports to fund boards, given the CCO's existing responsibility to administer the procedures in question, the Committee believes that the CCO would indeed be the right person. Moreover, the Committee believes that both concerns raised in your speech are addressed by the proposal that the delegation be optional. Consistent with their duties to a fund, directors would, in the ordinary course, consider whether a proposed delegation is in the fund's best interests and thus would necessarily include consideration of the appropriateness of the CCO as delegee.

Elimination of Quarterly Reviews Required by Existing Exemptive Orders

Based on its review of numerous exemptive orders that have been issued under the Act, the Committee observes that many of them have conditions that, like the three exemptive rules discussed above, require independent directors to adopt policies and procedures and to monitor the implementation of such policies and procedures. These types of conditions raise the same issues as the three exemptive orders – they require the independent directors to act as compliance analysts, which is not consistent with their supervisory authority over funds or in the best interests of investors. Rule 38a-1 requires funds operating in reliance on exemptive orders to have compliance policies and procedures reasonably designed to ensure compliance with the conditions in the exemptive orders relied upon, and makes the fund's CCO responsible for administering such policies and procedures.

The Committee recommends that the Staff consider supporting a blanket order or interpretation from the SEC that effectively amends the terms of existing exemptive orders such that directors may satisfy their monitoring responsibilities thereunder by receiving and reviewing quarterly reports from the CCO about compliance with policies and procedures adopted in connection with exemptive orders of this type. The Committee also recommends that the SEC consider incorporating this approach into exemptive rules codifying categories of frequently granted exemptive orders (including, *e.g.*, the pending rule proposals on changing subadvisers without shareholder approval and on exchange traded funds). This would be consistent with the approach recommended in the preceding section, and is also generally consistent with the proposed conditions for 19(b) orders released by the Staff late last year and which will presumably be reflected in the rule proposal for managed distribution plans that are contemplated in those conditions.

Determinations that Should be Made by the Adviser or Some Other Expert Subject to General Board Oversight Rather than by the Board

There are a number of rules that require board determinations that, in the Committee's view, unreasonably burden directors with responsibility for determinations that many of them may not be qualified to make except in reliance on others and that, in practice, must generally be made by the fund's adviser or some other expert and ratified by the board in reliance on such person's representations. The Committee has identified many examples of required determinations of this type. A few examples include: Rule 2a-7(a)(10)(ii) and (12)(ii), which require directors to determine that an "Unrated Security" is of comparable quality to a security meeting the requirement for a "Rated Security"; 17d-1(d)(7), which requires independent directors to find that each fund's share of a joint insurance policy premium is fair and reasonable "based upon its proportionate share of the sum of the premiums that would have been paid if such insurance coverage were purchased separately by the insured parties"; and Rule 23c-3(b)(10)(iii), which requires directors of closed-end interval funds to review portfolio composition in order to assure adequate liquidity to satisfy repurchase obligations.

The Committee suggests that the SEC revise all of such rules based on the following guiding principles. First, determinations that draw only upon professional investment expertise peculiarly within the possession of the adviser (*e.g.*, determining the comparable quality of Unrated Securities in Rule 2a-7) or that, if assigned to the directors, would require a degree and frequency of involvement that extends beyond the board's proper oversight role (*e.g.*, reviewing portfolio composition to assure adequate liquidity) should be left to the adviser, subject to the general oversight of the board of directors and the implementation of policies and procedures approved by the fund's board as part of the Rule 38a-1 compliance program. In addition, where the board's required involvement appears to be only a "checking" function (as in the comparable quality determinations under Rule 2a-7) assigned to the board as the only party available to appoint so that fund advisers would not be performing advisory duties solely on the honor system, the Committee recommends that the relevant rules should be amended to give independent directors the flexibility to delegate such checking to the CCO (who did not exist when these rules were adopted).

Fair Value Responsibilities under the Act

The Board's responsibility to determine, in good faith, the fair value of portfolio securities for which market quotations are not readily available, is unreasonably burdensome in the case of many funds. The Committee suggests that the SEC support an amendment to the Act to remove this requirement in recognition of the enormous changes to the fund industry and the financial markets since the requirement was enacted and that Board involvement in valuing specific portfolio assets is no longer necessary or appropriate. For example, accounting standards such as SFAS No. 157 (which "defines fair value, establishes a framework for measuring fair value [for purposes of GAAP], and expands disclosures about fair value measurements") provides a rigorous framework for determining fair values and must be used for a fund's financial statements from and after its implementation date. The Committee suggests that current accounting standards, as they may be amended or interpreted from time to time, and board oversight (including board approval of policies and procedures for valuing illiquid securities) together with the existence of a CCO, are sufficient to deal with the conflicts that advisers are subject to in connection with pricing securities for which market quotations do not exist. In the Committee's view, there is no reason to have fund boards directly involved in fair valuing securities and the current widespread practice of asking them to ratify specific fair values (thousands of such values in some cases), often months after the fact, is not satisfactory for many reasons and imposes an unreasonable burden on directors.

*　　　　*　　　　*

As noted above the Committee would be pleased to work with the Staff on the implementation of any or all of the above suggestions, and would also welcome the opportunity to discuss other opportunities to reduce unnecessary burdens on fund directors that the Staff has identified. Please do not hesitate to contact the undersigned by telephone at (212) 969-2108 or by e-mail at phil.kirstein@alliancebernstein.com.

Very truly yours,

Philip L. Kirstein
Chair

Attachment

Annex A

Committee Members

Susan Betteridge Baker	Margaret A. Bancroft	Jay Baris
Edmund P. Bergan	Kenneth J. Berman	Michael Bertisch
Greg Bressler	Georgia Bullitt	Michael R. Butowsky
Marty Byrne	Sarah E. Cogan	Don Crawshaw
Michael Doherty	Kay Gordon	Mary Joan Hoene
Michael K. Hoffman	Mark Holland	John G. Jerow, Secretary
Lawrence H. Kaplan	Phil Kirstein, Chairman	Laurin Blumenthal Kleiman
Hal Liebes	Frank J. Nasta	Margery Neale
Alexandra Poe	Kathryn L. Quirk	Judith Shandling
Nina O. Shenker	George Silfen	Matthew Simpson
A. Thomas Smith, III	Dan Steiner	David Stephens
Peter L. Tsirigotis	Thomas R. Westle	Julien Yoo
Anthony Zaccaria		Robert Zack

Drafting Committee

Donald R. Crawshaw
Alexandra Poe
Kathryn L. Quirk
Nina O. Shenker
Ronald M. Feiman