



December 3, 2003

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

Re: *Proposed Amendments to NYSE and Nasdaq Rules Relating to Corporate Governance (File Nos. SR-NYSE-2002-33, SR-NASD 2002-77, SR-NASD-2002-80, SR-NASD-2002-138, SR-NASD-2002-139 and SR-NASD-2002-141)*

Dear Mr. Katz:

The Investment Company Institute<sup>1</sup> is pleased to comment on the New York Stock Exchange's and Nasdaq's proposed corporate governance reforms.<sup>2</sup> We commend the self-regulatory organizations for taking this initiative to improve corporate governance by enhancing the role of independent directors and strengthening the oversight responsibilities of audit committees. We also are pleased that the proposed corporate governance reforms are consistent with each other and with a recent American Stock Exchange corporate governance proposal.<sup>3</sup> Such a coordinated approach ensures that the self-regulatory organizations do not compete on the basis of differences in their rules, encouraging a "race to the bottom" to attract new listings, to the ultimate detriment of investors.<sup>4</sup>

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<sup>1</sup> The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,672 open-end investment companies ("mutual funds"), 605 closed-end investment companies, 108 exchange-traded funds, and 6 sponsors of unit investment trusts. Its mutual fund members have assets of about \$7.149 trillion. These assets account for more than 95% of assets of all U.S. mutual funds. Individual owners represented by ICI member firms number 86.6 million as of mid 2003, representing 50.6 million households.

<sup>2</sup> See SEC Release No. 34-48745 (November 4, 2003) [68 FR 64154 (November 12, 2003)] ("Proposing Release"). The Release can be accessed on the SEC's website at <http://www.sec.gov/rules/sro/34-48745.htm>. The principal text of the NYSE's rule filing can be accessed on the NYSE's website at <http://www.nyse.com/pdfs/finalcorpgovrules.pdf>. The amendments filed by Nasdaq with the SEC can be viewed at <http://www.nasdaq.com/about/RecentRuleChanges.stm>.

<sup>3</sup> SEC Release No. 34-48706 (October 27, 2003) [68 FR 62109 (October 31, 2003)].

<sup>4</sup> In connection with each of the three self-regulatory organization corporate governance proposals, the SEC provided the bare minimum 21-day period for interested persons to comment. As the Institute has noted several times in the past, providing the public with only 21 days does not constitute meaningful opportunity to comment. We urge the SEC to lengthen the public comment period for any future significant self-regulatory organization rule proposals.

The Institute's perspectives on the proposal are as both investors in and issuers of securities. As investors in equity securities, the Institute's members rely on high-quality financial reporting to make investment decisions. Accordingly, the Institute strongly supports the proposal, which we believe will serve to enhance the interests of investors by improving the governance structure of listed companies and the integrity of financial reporting.

Our comments on the proposals focus on their application to investment companies as issuers. We are pleased that the proposals recognize that many of the proposed requirements are unnecessary for investment companies given the pervasive federal regulation applicable to them.<sup>5</sup> We strongly concur that with respect to investment companies, existing regulatory requirements satisfy many of the NYSE's and Nasdaq's policy goals, thereby making it unnecessary to apply the proposed requirements with respect to: independent directors; nominating/corporate governance committees; compensation committees; corporate governance guidelines; and codes of business conduct and ethics.<sup>6</sup> Our specific comments on the proposals are set forth below.

## **NYSE Proposal Regarding Audit Committees**

### *A. Service on Multiple Audit Committees*

The NYSE proposal provides that if an audit committee member simultaneously serves on the audit committee of more than three public companies, and the NYSE-listed company does not limit the number of audit committees on which its audit committee members serve, then in each case, the board would be required to determine that such simultaneous service would not impair the ability of the member to effectively serve on the listed company's audit committee ("determination requirement"). All companies, other than investment companies, also would be required to disclose such determination in their proxy statements or, if the company does not file an annual proxy statement, in the company's annual report on Form 10-K filed with the SEC. The NYSE's concern is to assure that audit committee members have the time needed to fulfill the audit committee's responsibilities, in light of the demands of other audit committee assignments.<sup>7</sup>

The Institute supports the NYSE's decision to exclude closed-end investment companies from the proposed disclosure requirement, recognizing that it is common practice to have the

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<sup>5</sup> See Proposing Release at pp. 64159-64160 and 64165. We also support excluding exchange-traded investment companies organized as unit investment trusts from all of the proposed requirements. Given the nature and structure of these companies, we believe that the proposed approach is necessary and appropriate.

<sup>6</sup> We previously provided the NYSE and Nasdaq with detailed comments explaining why, in those instances, it is unnecessary to apply the proposed requirements to investment companies. See Letter from Dorothy M. Donohue, Associate Counsel, Investment Company Institute, to James L. Cochrane, Senior Vice President, New York Stock Exchange, dated July 19, 2002; Letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, dated April 15, 2003; and Letter from Dorothy M. Donohue, Associate Counsel, Investment Company Institute to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, dated July 30, 2003.

<sup>7</sup> See Commentary to NYSE Section 303A(7)(a).

same directors serve on the boards of some or all the funds in a fund complex.<sup>8</sup> The Institute has a comment with respect to tailoring the determination requirement for closed-end investment companies. We recommend that the NYSE treat a "fund complex" as one company for this purpose.<sup>9</sup> We believe that this approach is appropriate because, typically, all funds in a fund complex rely on the same accounting system and are subject to the same internal controls and policies. In addition, an investment company's financial statements are less complicated than the financial statements of operating companies and therefore audit committee oversight requires less time.<sup>10</sup> Accordingly, the time and effort associated with overseeing the financial statements of each additional fund is less than the time and effort involved in serving on the audit committee of an additional operating company.<sup>11</sup> Moreover, the proposed requirement that all audit committee charters, including investment company audit committee charters, address an annual performance evaluation of the audit committee already would require investment companies to annually assess the duties and functions of their audit committees, which seems sufficient to address the NYSE's concern.<sup>12</sup>

### *B. Review of Earnings Information*

The Institute recommends excluding investment companies from the proposed requirement that audit committee members discuss earnings press releases as well as financial information and earnings guidance provided to analysts and rating agencies. Unlike operating companies, the computation of an investment company's earnings is straightforward because they are determined simply by calculating income and gains on portfolio investments less expenses. Moreover, in contrast to operating companies, the Internal Revenue Code essentially

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<sup>8</sup> *Id.* See also Letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, dated May 8, 2003.

<sup>9</sup> As we stated in our previous comment letter, in tailoring this requirement for investment companies, we recommend that the NYSE refer to the definition of "fund complex" in the Securities and Exchange Commission's proxy rules. See Item 22(a)(1)(vi) of Schedule 14A ("[t]he term "Fund Complex" shall mean two or more Funds that: (A) Hold themselves out to investors as related companies for purposes of investment and investor services; or (B) Have a common investment adviser or have an investment adviser that is an affiliated person of the investment adviser of any of the other Funds."). *Id.*

<sup>10</sup> Unlike operating companies, the assets of investment companies consist exclusively of investment securities, and, therefore, the accounting policies employed by investment companies are relatively straightforward (*e.g.*, investment securities are valued at the current market value). Further, gains and losses generally are determined by reference to market prices for the fund's securities. Consequently, there is little or no opportunity to engage in potentially abusive accounting practices.

<sup>11</sup> Indeed, the Public Company Accounting Oversight Board recently recognized that audits of investment companies are less complex than audits of operating companies due to their structure and the limited nature of their activities. See PCAOB Release No. 2003-003 (April 18, 2003) (establishing accounting support fees to fund operations of the Board).

<sup>12</sup> The NYSE could state in its commentary accompanying the final rules that the overall assessment of the audit committee should include consideration of how many audit committees board members serve on and whether they have the time needed to fulfill their audit committee responsibilities. The recommended approach would be consistent with Chairman Donaldson's recent suggestion that investment company boards should be required to perform an annual self-evaluation of their effectiveness, including consideration of the number of funds they oversee and the board's committee structure. See *Testimony Concerning Regulatory Reforms To Protect Our Nation's Mutual Fund Investors before the Senate Committee on Banking, Housing and Urban Affairs* (statement of William H. Donaldson, Chairman, U. S. Securities and Exchange Commission).

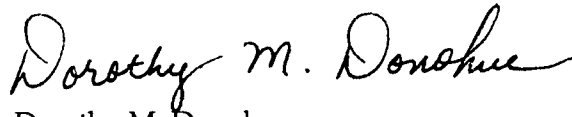
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requires investment companies to distribute earnings in the calendar year in which they are received. Because of the unique nature of investment companies, they do not have earnings targets, although they often release statements announcing quarterly investment results. These statements neither provide earnings guidance to security analysts nor contain complex detail comparable to earnings reports released by operating companies. Consequently, oversight of these earnings press releases by the audit committee is not necessary.

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The Institute appreciates the opportunity to comment on these significant corporate governance reform initiatives. If you have any questions or need additional information, please contact me at (202) 218-3563 or Amy B.R. Lancellotta at (202) 326-5824.

Sincerely,



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Associate Counsel

cc: James L. Cochrane,  
Senior Vice President  
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