August 21, 2006

Ms. Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: S7-03-04: Investment Company Governance

Dear Ms. Morris:

I appreciate the opportunity to comment on the Securities and Exchange Commission's proposal regarding mutual fund governance. I welcome the Commission's efforts to enhance investor protection. Requiring mutual fund boards to be composed of at least 75% independent directors will strengthen the integrity of the decision-making processes of boards and will thus promote the goal of protecting investors. However, I remain concerned that the requirement to have an independent chair is inconsistent with the 75% independence requirement. The latter empowers the board; the former takes away a key decision right. It seems contradictory to trust an independent board to make every key decision (i.e., fees, new board members, advisor contracts, etc.) except one, who the board's chair should be.

I am also concerned about the potential negative effects of regulatory "micromanagement" of the fund board's self-governance, unintentionally sapping entrepreneurial spirit from the board's activities. One need only look at some of the fastest growing segments of the investment industry (e.g., Hedge Funds and Independent RIAs) to see more efficient governance structures. This proposal could set an unintended precedent for additional regulation, making even wider the disparity in regulatory oversight of these segments that manage money for individual investors. It is imperative that we safeguard the innovative, entrepreneurial spirit that has been a hallmark of the mutual fund industry.

As the Commission is well aware, mutual funds, perhaps more than any other financial product, have democratized investing in the United States.,. In 1984, Charles Schwab & Co., Inc., launched its Mutual Fund MarketPlace® with 140 no-load mutual funds, pioneering what today is commonplace: allowing the investor to choose from among a variety of funds from a variety of fund families in one place. Eight years later, we launched our no-transaction fee Mutual Fund OneSource™ service, which reduced fees and helped make mutual funds the popular mainstream investment product they are today. Schwab was also an early pioneer in supporting the client-friendly concept of "open architecture" where high quality third-party funds are offered alongside strong proprietary funds to create optimal portfolios for individual investors.

These innovations helped fulfill one of the key goals of the Investment Company Act: promoting efficiency, competition and capital formation. Efficiency was achieved by bringing together in one place a broad array of funds and fund families and allowing the investor to choose those that best suit his or her needs and goals. And these innovations are at least in part responsible for the staggering flow of capital into mutual funds over the last two decades. In 1984, fewer than $400 billion was invested in U.S.-registered investment companies, among about 1,200 funds; today, that number is nearly $9 trillion invested in 8,000 funds.

The Schwab Funds board, which Charles R. Schwab chairs, has had a majority of independent directors since its inception in 1989, and has had a super-majority (70% or more) of independent directors since 2000 (currently the board is 77% independent), precisely because the board believed it to be in the best interest of investors. With a super-majority, independent directors have overwhelming authority in the selection of the chair and on all other matters before the board.

Many funds already choose to elect an independent director as a board chair because they believe it is in the best interest of investors. But other fund boards may decide that shareholder interests are best served by having an interested chair who is a powerful advocate within the larger investment advisory organization, or, for example, someone who founded the firm and who embodies the principles and innovative spirit upon which it is based. Such a chair has a significant stake in the success of the mutual fund family, and may inspire and motivate the staff managing the mutual funds.

As has been pointed out by numerous other comments throughout the Commission's consideration of the rule proposal, there exists little empirical evidence that funds with an independent chair have performed better, avoided scandal better, or have lower fees than funds with interested chairs. Indeed, there have been numerous examples of funds with independent chairs that have failed in their responsibilities, and plenty of examples of funds with interested chairs who have avoided scandal and upheld their commitment of integrity to their investors. The individual investor has ample opportunity to weigh how important an independent chair is to their investment decision when he or she considers purchasing fund shares. If having an independent chair is important to the investor, he or she can choose from among funds that meet that standard.

At Schwab, we believe that mutual fund shareholders and independent directors alike draw comfort from the fact that the chair of their mutual fund board has his name on the door of the company, and has an incentive to vigorously defend the principles upon which the brand is built. Independent directors should be able to decide whether they want to embrace in their board chair the entrepreneurial spirit and creative force behind the success of the mutual fund company. We believe that our entrepreneurial representative, working within the rigor and oversight of a 75% independent board, makes for a powerful combination. We also believe that this powerful corporate governance structure has contributed to the success of the Schwab Funds family, and that this type of success in turn is the best way to promote competition and capital formation.

I appreciate your consideration of my views and request that when deciding on the final rule, the Commission consider whether requiring an independent chair may produce an unintended consequence, that of actually weakening the decision-making latitude of the independent directors to do what they believe is in the best interest of fund shareholders.

Sincerely,

Evelyn Dilsaver
President, Schwab Funds

cc: Charles R. Schwab, Chairman, Schwab Funds