

108TH CONGRESS
1ST SESSION

H. R. 2420

To improve transparency relating to the fees and costs that mutual fund investors incur and to improve corporate governance of mutual funds.

IN THE HOUSE OF REPRESENTATIVES

JUNE 11, 2003

Mr. BAKER (for himself, Mr. GILLMOR, Mr. OSE, Mr. SHAYS, Mr. TIBERI, and Ms. GINNY BROWN-WAITE of Florida) introduced the following bill; which was referred to the Committee on Financial Services

A BILL

To improve transparency relating to the fees and costs that mutual fund investors incur and to improve corporate governance of mutual funds.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the “Mutual Funds Integ-
5 rity and Fee Transparency Act of 2003”.

6 **SEC. 2. IMPROVED TRANSPARENCY OF MUTUAL FUND**
7 **COSTS.**

8 (a) REGULATION REVISION REQUIRED.—Within 270
9 days after the date of enactment of this Act, the Securities

1 and Exchange Commission shall revise regulations under
2 the Securities Act of 1933, the Securities Exchange Act
3 of 1934, or the Investment Company Act of 1940, or any
4 combination thereof, to require, consistent with the protec-
5 tion of investors and the public interest, improved disclo-
6 sure with respect to an open-end management investment
7 company, in the quarterly statement or other periodic re-
8 port to shareholders or other appropriate disclosure docu-
9 ment, of the following:

10 (1) The estimated amount, in dollars, of the op-
11 erating expenses of the company that are borne by
12 each shareholder.

13 (2) The structure of, or method used to deter-
14 mine, the compensation of individuals employed by
15 the investment adviser of the company to manage
16 the portfolio of the company.

17 (3) The portfolio transaction costs of the com-
18 pany, including commissions paid with respect to the
19 trading of portfolio securities, set forth in a manner
20 that facilitates comparison among investment com-
21 panies.

22 (4) Information concerning the company's poli-
23 cies and practices with respect to the payment of
24 commissions for effecting securities transactions to a
25 member of an exchange, broker, or dealer who—

1 (A) furnishes advice, either directly or
2 through publications or writings, as to the value
3 of securities, the advisability of investing in,
4 purchasing, or selling securities, and the avail-
5 ability of securities or purchasers or sellers of
6 securities;

7 (B) furnishes analyses and reports con-
8 cerning issuers, industries, securities, economic
9 factors and trends, portfolio strategy, and the
10 performance of accounts; or

11 (C) facilitates the sale and distribution of
12 the company's shares.

13 (5) Information concerning payments by any
14 person other than the company that are intended to
15 facilitate the sale and distribution of the company's
16 shares.

17 (6) Information concerning discounts on front-
18 end sales loads for which investors may be eligible,
19 including the minimum purchase amounts required
20 for such discounts.

21 (b) DEFINITION.—For purposes of subsection (a), a
22 disclosure shall not be considered to be made in an appro-
23 priate disclosure document if the disclosure is made exclu-
24 sively in a prospectus or statement of additional informa-
25 tion, or both such documents.

1 **SEC. 3. OBLIGATIONS REGARDING CERTAIN DISTRIBUTION**
 2 **AND SOFT DOLLAR ARRANGEMENTS.**

3 Section 15 of the Investment Company of 1940 (15
 4 U.S.C. 80a-15) is amended by adding at the end the fol-
 5 lowing new subsection:

6 “(g) OBLIGATIONS REGARDING CERTAIN DISTRIBUTION AND SOFT DOLLAR ARRANGEMENTS.—

8 “(1) REPORTING REQUIREMENTS.—Each in-
 9 vestment adviser to a registered investment company
 10 shall, no less frequently than annually, submit to the
 11 board of directors of the company a report on—

12 “(A) payments during the reporting period
 13 by the adviser (or an affiliated person of the
 14 adviser) that were directly or indirectly made
 15 for the purpose of promoting the sale of shares
 16 of the investment company (referred to in para-
 17 graph (2) as a ‘revenue sharing arrangement’);

18 “(B) services to the company provided or
 19 paid for by a broker or dealer or an affiliated
 20 person of the broker or dealer (other than bro-
 21 kerage and research services) in exchange for
 22 the direction of brokerage to the broker or deal-
 23 er (referred to in paragraph (2) as a ‘directed
 24 brokerage arrangement’); and

25 “(C) research services obtained by the ad-
 26 viser (or an affiliated person of the adviser)

1 during the reporting period from a broker or
2 dealer the receipt of which may reasonably be
3 attributed to securities transactions effected on
4 behalf of the company or any other company
5 that is a member of the same group of invest-
6 ment companies (referred to in paragraph (2)
7 as a ‘soft dollar arrangement’).

8 “(2) FIDUCIARY DUTY OF BOARD OF DIREC-
9 TORS.—The board of directors of a registered invest-
10 ment company shall have a fiduciary duty—

11 “(A) to supervise the investment adviser’s
12 direction of the company’s brokerage trans-
13 actions, including directed brokerage arrange-
14 ments and soft dollar arrangements, and to de-
15 termine that the direction of such brokerage is
16 in the best interests of the shareholders of the
17 company; and

18 “(B) to supervise any revenue sharing ar-
19 rangements to ensure compliance with this Act
20 and the rules adopted thereunder, and to deter-
21 mine that such revenue sharing arrangements
22 are in the best interests of the shareholders of
23 the company.

24 “(3) REGULATIONS.—The Commission shall
25 adopt rules and regulations implementing this sec-

1 tion, which rules and regulations shall, among other
2 things, prescribe the content of the required reports.

3 “(4) DEFINITION.—For purposes of this sub-
4 section—

5 “(A) the term ‘brokerage and research
6 services’ has the same meaning as in section
7 28(e)(3) of the Securities Exchange Act of
8 1934; and

9 “(B) the term ‘research services’ means
10 the services described in subparagraphs (A) and
11 (B) of such section.”.

12 **SEC. 4. MUTUAL FUND GOVERNANCE.**

13 (a) DIRECTOR AND CHAIRMAN INDEPENDENCE.—
14 Section 10(a) of the Investment Company Act of 1940 (15
15 U.S.C. 80a–10) is amended—

16 (1) by striking “60 per centum” and inserting
17 “one-third”; and

18 (2) by inserting “, nor shall such registered
19 company have as chairman of such board an inter-
20 ested person of such registered company” before the
21 period.

22 (b) DEFINITION OF INTERESTED PERSON.—Section
23 2(a)(19) of the Investment Company Act of 1940 (15
24 U.S.C. 80a–2(a)(19)) is amended—

25 (1) in subparagraph (A)—

1 (A) by striking clause (vi) and redesignating
2 clause (vii) as clause (vi); and

3 (B) by amending clause (v) to read as follows:
4

5 “(v) any natural person who is a
6 member of a class of persons who the
7 Commission, by rule or regulation, determines
8 are unlikely to exercise an appropriate
9 degree of independence as a result
10 of—

11 “(I) a material business or professional
12 relationship with the company or any affiliated
13 person of the company, or
14

15 “(II) a close familial relationship
16 with any natural person who is an affiliated
17 person of the company,”; and

18 (2) in subparagraph (B)—

19 (A) by striking clause (vi) and redesignating
20 clause (vii) as clause (vi); and

21 (B) by amending clause (v) to read as follows:
22

23 “(v) any natural person who is a
24 member of a class of persons who the
25 Commission, by rule or regulation, deter-

mines are unlikely to exercise an appropriate degree of independence as a result of—

“(I) a material business or professional relationship with such investment adviser or principal underwriter (or affiliated person thereof), or

“(II) a close familial relationship with a natural person who is such investment adviser or principal underwriter (or affiliated person thereof).”.

SEC. 5. AUDIT COMMITTEE REQUIREMENTS FOR INVESTMENT COMPANIES.

(a) AMENDMENTS.—Section 32 of the Investment Company Act of 1940 (15 U.S.C. 80a–31) is amended—

(1) by striking paragraphs (1) and (2) of subsection (a) and inserting the following:

“(1) such accountant shall have been selected at a meeting held within 30 days before or after the beginning of the fiscal year or before the annual meeting of stockholders in that year by the vote, cast in person, of a majority of the members of the audit committee of such registered company;

“(2) such selection shall have been submitted for ratification or rejection at the next succeeding

1 annual meeting of stockholders if such meeting be
 2 held, except that any vacancy occurring between an-
 3 nual meetings, due to the death or resignation of the
 4 accountant, may be filled by the vote of a majority
 5 of the members of the audit committee of such reg-
 6 istered company, cast in person at a meeting called
 7 for the purpose of voting on such action;” and

8 (2) by adding at the end the following new sub-
 9 section:

10 “(d) AUDIT COMMITTEE REQUIREMENTS.—

11 “(1) REQUIREMENTS AS PREREQUISITE TO FIL-
 12 ING FINANCIAL STATEMENTS.—Any registered man-
 13 agement company or registered face-amount certifi-
 14 cate company that files with the Commission any fi-
 15 nancial statement signed or certified by an inde-
 16 pendent public accountant shall comply with the re-
 17 quirements of paragraphs (2) through (6) of this
 18 subsection and any rule or regulation of the Com-
 19 mission issued thereunder.

20 “(2) RESPONSIBILITY RELATING TO INDE-
 21 PENDENT PUBLIC ACCOUNTANTS.—The audit com-
 22 mittee of the registered company, in its capacity as
 23 a committee of the board of directors, shall be di-
 24 rectly responsible for the appointment, compensa-
 25 tion, and oversight of the work of any independent

1 public accountant employed by such registered com-
2 pany (including resolution of disagreements between
3 management and the auditor regarding financial re-
4 porting) for the purpose of preparing or issuing the
5 audit report or related work, and each such inde-
6 pendent public accountant shall report directly to
7 the audit committee.

8 “(3) INDEPENDENCE.—

9 “(A) IN GENERAL.—Each member of the
10 audit committee of the registered company shall
11 be a member of the board of directors of the
12 company, and shall otherwise be independent.

13 “(B) CRITERIA.—In order to be considered
14 to be independent for purposes of this para-
15 graph, a member of an audit committee of a
16 registered company may not, other than in his
17 or her capacity as a member of the audit com-
18 mittee, the board of directors, or any other
19 board committee—

20 “(i) accept any consulting, advisory,
21 or other compensatory fee from the reg-
22 istered company or any affiliated person of
23 the registered company; or

1 “(ii) be an ‘interested person’ of the
2 registered company, as such term is de-
3 fined in section 2(a)(19).

4 “(4) COMPLAINTS.—The audit committee of the
5 registered company shall establish procedures for—

6 “(A) the receipt, retention, and treatment
7 of complaints received by the registered com-
8 pany regarding accounting, internal accounting
9 controls, or auditing matters; and

10 “(B) the confidential, anonymous submis-
11 sion by employees of the registered company
12 and its affiliated persons of concerns regarding
13 questionable accounting or auditing matters.

14 “(5) AUTHORITY TO ENGAGE ADVISERS.—The
15 audit committee of the registered company shall
16 have the authority to engage independent counsel
17 and other advisers, as it determines necessary to
18 carry out its duties.

19 “(6) FUNDING.—The registered company shall
20 provide appropriate funding, as determined by the
21 audit committee, in its capacity as a committee of
22 the board of directors, for payment of compensa-
23 tion—

24 “(A) to the independent public accountant
25 employed by the registered company for the

1 purpose of rendering or issuing the audit re-
 2 port; and

3 “(B) to any advisers employed by the audit
 4 committee under paragraph (5).

5 “(7) AUDIT COMMITTEE.—For purposes of this
 6 subsection, the term ‘audit committee’ means—

7 “(A) a committee (or equivalent body) es-
 8 tablished by and amongst the board of directors
 9 of a registered investment company for the pur-
 10 pose of overseeing the accounting and financial
 11 reporting processes of the company and audits
 12 of the financial statements of the company; and

13 “(B) if no such committee exists with re-
 14 spect to a registered investment company, the
 15 entire board of directors of the company.”.

16 (b) CONFORMING AMENDMENT.—Section 10A(m) of
 17 the Securities Exchange Act of 1934 is amended by add-
 18 ing at the end the following new paragraph:

19 “(7) EXEMPTION FOR INVESTMENT COMPA-
 20 NIES.—Effective one year after the date of enact-
 21 ment of the Mutual Funds Integrity and Fee Trans-
 22 parency Act of 2003, for purposes of this subsection,
 23 the term ‘issuer’ shall not include any investment
 24 company that is registered under section 8 of the In-
 25 vestment Company Act of 1940.”.

1 (c) IMPLEMENTATION.—Not later than 180 days
2 after the date of enactment of this Act, the Securities and
3 Exchange Commission shall issue final regulations to
4 carry out section 32(d) of the Investment Company Act
5 of 1940, as added by subsection (a) of this section.

6 **SEC. 6. COMMISSION STUDY AND REPORT REGULATING**
7 **SOFT DOLLAR ARRANGEMENTS.**

8 (a) STUDY REQUIRED.—

9 (1) IN GENERAL.—The Commission shall con-
10 duct a study of the use of soft dollar arrangements
11 by investment advisers as contemplated by section
12 28(e) of the Securities Exchange Act of 1934 (15
13 U.S.C. 78bb(e)).

14 (2) AREAS OF CONSIDERATION.—The study re-
15 quired by this section shall examine—

16 (A) the trends in the average amounts of
17 soft dollar commissions paid by investment ad-
18 visers and investment companies in the past 3
19 years;

20 (B) the types of services provided through
21 soft dollar arrangements;

22 (C) the extent to which use of soft dollar
23 arrangements impairs the ability of mutual
24 fund investors to evaluate and compare the ex-
25 penses of different mutual funds;

1 (D) the conflicts of interest created by soft
2 dollar arrangements;

3 (E) the transparency of such soft dollar
4 arrangements to investment company share-
5 holders and investment advisory clients of in-
6 vestment advisers; and

7 (F) whether such section 28(e) should be
8 repealed or modified.

9 (b) REPORT REQUIRED.—The Commission shall sub-
10 mit a report on the study required by subsection (a) to
11 the Committee on Financial Services of the House of Rep-
12 resentatives and the Committee on Banking, Housing and
13 Urban Affairs of the Senate, no later than 18 months
14 after the date of enactment of this Act.

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