

U.S. TERRITORIES INVESTOR PROTECTION ACT OF 2017

MAY 1, 2017.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. HENSARLING, from the Committee on Financial Services,
submitted the following

R E P O R T

[To accompany H.R. 1366]

[Including cost estimate of the Congressional Budget Office]

The Committee on Financial Services, to whom was referred the bill (H.R. 1366) to amend the Investment Company Act of 1940 to terminate an exemption for companies located in Puerto Rico, the Virgin Islands, and any other possession of the United States, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

PURPOSE AND SUMMARY

Introduced by Representative Nydia Velasquez on March 6, 2017, H.R. 1366, the U.S. Territories Investor Protection Act of 2017, amends Section 6(a)(1) of the Investment Company Act of 1940 to terminate an exemption for investment companies located in Puerto Rico, the Virgin Islands, and any other possession of the United States. Under current law, such companies are exempt from registration under the Act provided that their shares are sold solely to the residents of the territory or possession in which they are located. The bill provides an automatic three-year safe harbor for investment companies that currently enjoy this exemption. Additionally, the bill authorizes the SEC to further delay the effective date (or end of the exemption) for a maximum of three years following the initial three year safe harbor.

BACKGROUND AND NEED FOR LEGISLATION

When Congress enacted the Investment Company Act of 1940, it was prohibitively expensive and logistically difficult for SEC personnel to travel and inspect investment companies located in cer-

tain U.S. territories, including Alaska, Hawaii, the Philippines, the Panama Canal Zone, Puerto Rico and the U.S. Virgin Islands.

Consequently, those investment companies were exempt from registration with, and oversight by, the SEC, but the investment company had to follow the laws of the jurisdiction in which the investment company operated. As U.S. territories and possessions became states or independent nations no longer under U.S. control, amendments were made to Section 6(a)(1). As the burdens and costs of travel are not the same today as they were in 1940, H.R. 1366 terminates this anachronistic exemption from registration under the Act. Thus, the bill ensures that investment companies in Puerto Rico, Guam, and elsewhere will operate subject to the same rules as their mainland counterparts, consistent with the SEC's ability to gather information quickly using modern technology regardless of distance.

HEARINGS

The Committee on Financial Services' held no hearings examining matters relating to H.R. 1366.

COMMITTEE CONSIDERATION

The Committee on Financial Services met in open session on March 9, 2017 and ordered H.R. 1366 to be reported favorably to the House without amendment by a recorded vote of 58 yeas to 0 nays (recorded vote no. FC-34), a quorum being present.

COMMITTEE VOTES

Clause 3(b) of rule XIII of the Rules of the House of Representatives requires the Committee to list the record votes on the motion to report legislation and amendments thereto. The sole recorded vote in committee was a motion by Chairman Hensarling to report the bill favorably to the House without amendment. That motion was agreed to by a recorded vote of 58 yeas to 0 nays (Record vote no. FC-34), a quorum being present.

Record vote no. FC-34

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Hensarling	X			Ms. Maxine Waters (CA)	X		
Mr. McHenry	X			Mrs. Carolyn B. Maloney (NY) ..	X		
Mr. King	X			Ms. Velázquez	X		
Mr. Royce (CA)	X			Mr. Sherman	X		
Mr. Lucas	X			Mr. Meeks	X		
Mr. Pearce	X			Mr. Capuano	X		
Mr. Posey	X			Mr. Clay	X		
Mr. Luetkemeyer	X			Mr. Lynch	X		
Mr. Huizenga	X			Mr. David Scott (GA)	X		
Mr. Duffy	X			Mr. Al Green (TX)	X		
Mr. Stivers	X			Mr. Cleaver	X		
Mr. Hultgren	X			Ms. Moore	X		
Mr. Ross	X			Mr. Ellison	X		
Mr. Pittenger	X			Mr. Perlmutter	X		
Mrs. Wagner	X			Mr. Himes	X		
Mr. Barr	X			Mr. Foster	X		
Mr. Rothfus	X			Mr. Kildee	X		
Mr. Messer	X			Mr. Delaney	X		
Mr. Tipton	X			Ms. Sinema			
Mr. Williams	X			Mrs. Beatty	X		
Mr. Poliquin	X			Mr. Heck	X		
Mrs. Love	X			Mr. Vargas	X		
Mr. Hill	X			Mr. Gottheimer	X		
Mr. Emmer	X			Mr. Gonzalez (TX)	X		
Mr. Zeldin	X			Mr. Crist	X		
Mr. Trott	X			Mr. Kihuen	X		
Mr. Loudermilk	X						
Mr. Mooney (WV)	X						
Mr. MacArthur	X						
Mr. Davidson	X						
Mr. Budd	X						
Mr. Kustoff (TN)							
Ms. Tenney	X						
Mr. Hollingsworth	X						

COMMITTEE OVERSIGHT FINDINGS

Pursuant to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the findings and recommendations of the committee based on oversight activities under clause 2(b)(1) of rule X of the Rules of the House of Representatives, are incorporated in the descriptive portions of this report.

PERFORMANCE GOALS AND OBJECTIVES

Pursuant to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee states that H.R. 1366 will protect U.S. territories investments by terminating the exemptions for investment companies located in U.S. territories, and ensuring that they are subject to the same requirements and oversight by the SEC.

NEW BUDGET AUTHORITY, ENTITLEMENT AUTHORITY, AND TAX EXPENDITURES

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee adopts as its own the estimate of new budget authority, entitlement authority, or tax expenditures or revenues contained in the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974.

COMMITTEE COST ESTIMATE

The Committee adopts as its own the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974.

CONGRESSIONAL BUDGET OFFICE ESTIMATES

Pursuant to clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, the following is the cost estimate provided by the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, April 4, 2017.

Hon. JEB HENSARLING,
*Chairman, Committee on Financial Services,
House of Representatives, Washington, DC.*

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 1366, the U.S. Territories Investor Protection Act of 2017.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Stephen Rabent.

Sincerely,

KEITH HALL.

Enclosure.

H.R. 1366—U.S. Territories Investor Protection Act of 2017

Under current law, the Securities and Exchange Commission (SEC) requires some issuers of securities to register as an investment company and regulates aspects of their operations. Investment companies that are located in Puerto Rico, the Virgin Islands, or other United States possessions are exempt from registration under certain conditions and therefore, exempt from the related regulations that apply to investment companies. H.R. 1366 would remove that exemption three years after the date of enactment of the bill; however, the SEC could extend the exemption for up to three additional years following the initial three-year period.

Based on an analysis of information from the SEC, CBO estimates that implementing H.R. 1366 would have no significant effect on the agency's costs or operations to extend current regulations to include those companies. Moreover, the SEC is authorized to collect fees sufficient to offset its annual appropriation; therefore, CBO estimates that the net effect on discretionary spending would be negligible, assuming appropriation actions consistent with that authority.

Enacting H.R. 1366 would not affect direct spending or revenues; therefore, pay-as-you-go procedures do not apply. CBO estimates that enacting H.R. 1366 would not increase net direct spending or on-budget deficits in any of the four consecutive 10-year periods beginning in 2028.

H.R. 1366 contains no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would not affect the budgets of state, local, or tribal governments.

By removing their regulatory exemption under the Investment Company Act the bill would impose a private-sector mandate on investment companies that are headquartered in a U.S. territory and that sell securities exclusively to residents of that territory. Without the exemption those companies would be subject to existing federal requirements for investment companies such as registering with the SEC, meeting minimum capital requirements, making disclosures to investors and registering the securities that they offer.

The cost of the mandate would include registration fees and the ongoing costs of complying with SEC requirements. Based on an estimate of the total asset size of the investment companies that could be affected and the current rates of regulatory fees that would apply to those companies, CBO estimates that the aggregate cost of the mandate would fall below the annual threshold established in UMRA for private-sector mandates (\$156 million in 2017, adjusted annually for inflation).

On April 4, 2017, CBO transmitted a cost estimate for S. 484, the U.S. Territories Investor Protection Act of 2017, as reported by the Senate Committee on Banking, Housing, and Urban Affairs on March 13, 2017. The two bills are similar and CBO's estimate of their budgetary effects is the same.

The CBO staff contacts for this estimate are Stephen Rabent (for federal costs) and Logan Smith (for private-sector mandates). The estimate was approved by H. Samuel Papenfuss, Deputy Assistant Director for Budget Analysis.

FEDERAL MANDATES STATEMENT

The Committee adopts as its own the estimate of Federal mandates prepared by the Director of the Congressional Budget Office pursuant to section 423 of the Unfunded Mandates reform Act.

ADVISORY COMMITTEE STATEMENT

No advisory committees within the meaning of section 5(b) of the Federal Advisory Committee Act were created by this legislation.

APPLICABILITY TO LEGISLATIVE BRANCH

The Committee finds that the legislation does not relate to the terms and conditions of employment or access to public services or accommodations within the meaning of the section 102(b)(3) of the Congressional Accountability Act.

EARMARK IDENTIFICATION

H.R. 1366 does not contain any congressional earmarks, limited tax benefits, or limited tariff benefits as defined in clause 9 of rule XXI.

DUPLICATION OF FEDERAL PROGRAMS

Pursuant to section 3(c)(5) of rule XIII, the Committee states that no provision of H.R. 1366 establishes or reauthorizes a program of the Federal Government known to be duplicative of another Federal program, a program that was included in any report from the Government Accountability Office to Congress pursuant to section 21 of Public Law 111-139, or a program related to a program identified in the most recent Catalog of Federal Domestic Assistance.

DISCLOSURE OF DIRECTED RULEMAKING

Pursuant to section 3(i) of H. Res. 5, 115th Cong. (2017), the Committee states that H.R. 1366 contains no directed rulemaking.

SECTION-BY-SECTION ANALYSIS OF THE LEGISLATION

Section 1: Short title

This section cites H.R. 1366 as the “U.S. Territories Investor Protection Act of 2017.”

Section 2: Termination of exemption

This section amends the Investment Company Act of 1940 by eliminating the exemption provided to U.S. possessions under section 6(a)(1) of the Act. The exemption will take effect three years after enactment. This section also provides the SEC with the authority to extend the safe harbor to a maximum of three years, in addition to the initial three year period.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omit-

ted is enclosed in black brackets and existing law in which no change is proposed is shown in roman):

INVESTMENT COMPANY ACT OF 1940

TITLE I—INVESTMENT COMPANIES

* * * * *

EXEMPTIONS

SEC. 6. (a) The following investment companies are exempt from the provisions of this title:

【(1) Any company organized or otherwise created under the laws of and having its principal office and place of business in Puerto Rico, the Virgin Islands, or any other possession of the United States; but such exemption shall terminate if any security of which such company is the issuer is offered for sale or sold after the effective date of this title, by such company or an underwriter therefor, to a resident of any State other than the State in which such company is organized.】

(2) Any company which since the effective date of this title or within five years prior to such date has been reorganized under the supervision of a court of competent jurisdiction, if (A) such company was not an investment company at the commencement of such reorganization proceedings, (B) at the conclusion of such proceedings all outstanding securities of such company were owned by creditors of such company or by persons to whom such securities were issued on account of creditors' claims, and (C) more than 50 per centum of the voting securities of such company, and securities representing more than 50 per centum of the net asset value of such company, are currently owned beneficially by not more than twenty-five persons; but such exemption shall terminate if any security of which such company is the issuer is offered for sale or sold to the public after the conclusion of such proceedings by the issuer or by or through any underwriter. For the purposes of this paragraph, any new company organized as part of the reorganization shall be deemed the same company as its predecessor; and beneficial ownership shall be determined in the manner provided in section 3(c)(1).

(3) Any issuer as to which there is outstanding a writing filed with the Commission by the Federal Savings and Loan Insurance Corporation stating that exemption of such issuer from the provisions of this title is consistent with the public interest and the protection of investors and is necessary or appropriate by reason of the fact that such issuer holds or proposes to acquire any assets or any product of any assets which have been segregated (A) from assets of any company which at the filing of such writing is an insured institution within the meaning of section 401(a) of the National Housing Act, as heretofore or hereafter amended, or (B) as a part of or in connection with any plan for or condition to the insurance of accounts of any company by said corporation or the conversion of any company into a Federal savings and loan association. Any such writing shall expire when canceled by a writing similarly filed

or at the expiration of two years after the date of its filing, whichever first occurs; but said corporation may, nevertheless, before, at, or after the expiration of any such writing file another writing or writings with respect to such issuer.

(4) Any company which prior to March 15, 1940, was and now is a wholly-owned subsidiary of a registered face-amount certificate company and was prior to said date and now is organized and operating under the insurance laws of any State and subject to supervision and examination by the insurance commissioner thereof, and which prior to March 15, 1940, was and now is engaged, subject to such laws, in business substantially all of which consists of issuing and selling only to residents of such State and investing the proceeds from, securities providing for or representing participations or interests in intangible assets consisting of mortgages or other liens on real estate or notes or bonds secured thereby or in a fund or deposit of mortgages or other liens on real estate or notes or bonds secured thereby or having outstanding such securities so issued and sold.

(5)(A) Any company that is not engaged in the business of issuing redeemable securities, the operations of which are subject to regulation by the State in which the company is organized under a statute governing entities that provide financial or managerial assistance to enterprises doing business, or proposing to do business, in that State if—

(i) the organizational documents of the company state that the activities of the company are limited to the promotion of economic, business, or industrial development in the State through the provision of financial or managerial assistance to enterprises doing business, or proposing to do business, in that State, and such other activities that are incidental or necessary to carry out that purpose;

(ii) immediately following each sale of the securities of the company by the company or any underwriter for the company, not less than 80 percent of the securities of the company being offered in such sale, on a class-by-class basis, are held by persons who reside or who have a substantial business presence in that State;

(iii) the securities of the company are sold, or proposed to be sold, by the company or by any underwriter for the company, solely to accredited investors, as that term is defined in section 2(a)(15) of the Securities Act of 1933, or to such other persons that the Commission, as necessary or appropriate in the public interest and consistent with the protection of investors, may permit by rule, regulation, or order; and

(iv) the company does not purchase any security issued by an investment company or by any company that would be an investment company except for the exclusions from the definition of the term “investment company” under paragraph (1) or (7) of section 3(c), other than—

(I) any debt security that meets such standards of credit-worthiness as the Commission shall adopt; or

(II) any security issued by a registered open-end investment company that is required by its investment

policies to invest not less than 65 percent of its total assets in securities described in subclause (I) or securities that are determined by such registered open-end investment company to be comparable in quality to securities described in subclause (I).

(B) Notwithstanding the exemption provided by this paragraph, section 9 (and, to the extent necessary to enforce section 9, sections 38 through 51) shall apply to a company described in this paragraph as if the company were an investment company registered under this title.

(C) Any company proposing to rely on the exemption provided by this paragraph shall file with the Commission a notification stating that the company intends to do so, in such form and manner as the Commission may prescribe by rule.

(D) Any company meeting the requirements of this paragraph may rely on the exemption provided by this paragraph upon filing with the Commission the notification required by subparagraph (C), until such time as the Commission determines by order that such reliance is not in the public interest or is not consistent with the protection of investors.

(E) The exemption provided by this paragraph may be subject to such additional terms and conditions as the Commission may by rule, regulation, or order determine are necessary or appropriate in the public interest or for the protection of investors.

(b) Upon application by any employees' security company, the Commission shall by order exempt such company from the provisions of this title and of the rules and regulations hereunder, if and to the extent that such exemption is consistent with the protection of investors. In determining the provisions to which such an order of exemption shall apply, the Commission shall give due weight, among other things, to the form of organization and the capital structure of such company, the persons by whom its voting securities, evidences of indebtedness, and other securities are owned and controlled, the prices at which securities issued by such company are sold and the sales load thereon, the disposition of the proceeds of such sales, the character of the securities in which such proceeds are invested, and any relationship between such company and the issuer of any such security.

(c) The Commission, by rules and regulations upon its own motion, or by order upon application, may conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of this title or of any rule or regulation thereunder, if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this title.

(d) The Commission, by rules and regulations or order, shall exempt a closed-end investment company from any or all provisions of this title, but subject to such terms and conditions as may be necessary or appropriate in the public interest or for the protection of investors, if—

(1) the aggregate sums received by such company from the sale of all its outstanding securities, plus the aggregate offer-

ing price of all securities of which such company is the issuer and which it proposes to offer for sale, do not exceed \$10,000,000, or such other amount as the Commission may set by rule, regulation, or order;

(2) no security of which such company is the issuer has been or is proposed to be sold by such company or any underwriter therefor, in connection with a public offering, to any person who is not a resident of the State under the laws of which such company is organized or otherwise created; and

(3) such exemption is not contrary to the public interest or inconsistent with the protection of investors.

(e) If, in connection with any rule, regulation, or order under this section exempting any investment company from any provision of section 7, the Commission deems it necessary or appropriate in the public interest or for the protection of investors that certain specified provisions of this title pertaining to registered investment companies shall be applicable in respect of such company, the provisions so specified shall apply to such company, and to other persons in their transactions and relations with such company, as though such company were a registered investment company.

(f) Any closed-end company which—

(1) elects to be treated as a business development company pursuant to section 54; or

(2) would be excluded from the definition of an investment company by section 3(c)(1), except that it presently proposes to make a public offering of its securities as a business development company, and has notified the Commission, in a form and manner which the Commission may, by rule, prescribe, that it intends in good faith to file, within 90 days, a notification of election to become subject to the provisions of sections 55 through 65,

shall be exempt from sections 1 through 53, except to the extent provided in sections 59 through 65.

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