

## PROTECTION OF SOURCE CODE ACT

—  
FEBRUARY 8, 2018.—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

together with

### MINORITY VIEWS

[To accompany H.R. 3948]

[Including cost estimate of the Congressional Budget Office]

The Committee on Financial Services, to whom was referred the bill (H.R. 3948) to prohibit the Securities and Exchange Commission from compelling a person to produce or furnish algorithmic trading source code or similar intellectual property to the Commission unless the Commission first issues a subpoena, and for other purposes, having considered the same, reports favorably thereon with amendments and recommends that the bill as amended do pass.

The amendments (stated in terms of the page and line numbers of the introduced bill) are as follows:

Page 2, line 11, strike “or provides insight to”.

Page 2, line 22, strike “or provides insight to”.

Page 3, line 6, strike “or provides insight to”.

Page 3, line 18, strike “or provides insight to”.

### PURPOSE AND SUMMARY

On October 4, 2017, Representatives Sean Duffy and David Scott introduced the “Protection of Source Code Act”, which amends the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, and the Investment Advisers Act of 1940 to require the Securities and Exchange Commission (SEC) to first issue a subpoena before it compels a person to produce or

furnish to the SEC algorithmic trading source code or similar intellectual property.

#### BACKGROUND AND NEED FOR LEGISLATION

The goal of H.R. 3948 is to ensure appropriate due process over highly sensitive proprietary algorithmic information and prevent the SEC from accessing certain intellectual property from a registered entity without a subpoena.

In December 2015, the Commodity Futures Trading Commission (CFTC) issued a proposed rulemaking known as Regulation Automated Trading (Reg AT). The proposed rulemaking stated that companies would be required to give their proprietary source code data at the request of a CFTC staffer. After pushback from regulated entities and commentators, the CFTC required that the CFTC must vote in order to gain access to source code.

The CFTC's proposed rule received pushback because it eliminated due process for companies and individuals with proprietary ownership over source code data. After all, owners of source code have a legal right as property owners against the seizure of their property by the federal government. If the CFTC, or any other agency, wants to obtain proprietary or source code data, basic notions of due process demands a subpoena. In his statement of dissent then-Commissioner Giancarlo observed that Reg AT as-proposed would be open to a constitutional challenge because it could be classified as an unreasonable search and seizure. On October 4, 2017, CFTC Commissioner Brian Quintez said the CFTC's controversial source code repository proposal was "D-E-A-D."

Nonetheless, the CFTC's overreaching proposal raised concerns that other government agencies could follow their lead. In his dissent from Reg AT, Chairman Giancarlo predicted as much: "If the CFTC adopts the source code provisions of the Supplemental Notice, the [SEC] will likely copy it and so will other U.S. and overseas regulators—and not just regulators of financial markets." Thus, it became incumbent on Congress to ensure that other regulators, including the SEC, do not follow suit.

On August 10, 2016, Congressman Sean Duffy sent a letter to former SEC Chair Mary Jo White to express his concerns with Reg AT and inquired as to whether the SEC might apply a similar approach to companies and individuals that they oversee. In a response letter, Chair White did not foreclose the possibility that the SEC would follow a similar course as the CFTC and did not provide comments on the CFTC rule and whether it would inform future SEC actions.

H.R. 3948 removes any such doubt and would prohibit the SEC from compelling the production of source code or similar intellectual property without a subpoena. Not only does H.R. 3948 ensure important due process protections, H.R. 3948 will help ensure the security of SEC-regulated entities' proprietary data and information. Companies invest billions of dollars to ensure the integrity of their information technology systems. During a hearing on October 11, 2017, Rep. David Scott noted that source code is the "secret sauce" of the industry. In other words, the seizure of proprietary data essentially equates to the seizure of the company. Given the 2017 announcement of the breach of the SEC's EDGAR system and valid concerns about the SEC's ability to protect sensitive data, it

is even more important to place safeguards on the SEC's ability to access, without cause, highly sensitive, proprietary trading data.

Notably, H.R. 3948 balances due process right and cyber security concerns while still preserving the SEC's ability to obtain this information in its normal course upon an appropriate showing. Generally, the SEC relies on its subpoena authority to obtain such data; this bill only codifies that approach in order to head off the possibility that the SEC could follow the groundwork laid by the CFTC's proposed approach. Allowing a federal agency, such as the SEC, to more freely collect highly sensitive proprietary trading algorithms without sufficient due process protections will only increase the SEC's attractiveness as a highly-prized target for cyber intrusions. Due process and security concerns thus far outweigh any benefit the SEC may gain from being able to request such data without demonstrating an appropriate need for it.

#### HEARINGS

The Committee on Financial Services held a hearing examining matters relating to H.R. 3948 on April 26, 2017, and April 28, 2017.

#### COMMITTEE CONSIDERATION

The Committee on Financial Services met in open session on October 11, 2017, and October 12, 2017 and ordered H.R. 3948 to be reported favorably to the House as amended by a recorded vote of 46 yeas to 14 nays (Record vote no. FC-94), a quorum being present. Before the motion to report was offered, the Committee adopted an amendment offered by Mr. Foster by voice vote.

#### 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 was on a motion by Chairman Hensarling to report the bill favorably to the House as amended. The motion was agreed to by a recorded vote of 46 yeas to 14 nays (Record vote no. FC-94), a quorum being present.

Present	Representative	Yeas	Nays
	Mr. HENSARLING, <i>Chairman</i>	✓	
	Mr. McHENRY	✓	
	Mr. KING	✓	
	Mr. ROYCE	✓	
	Mr. LUCAS	✓	
	Mr. PEARCE	✓	
	Mr. POSEY	✓	
	Mr. LUETKEMEYER	✓	
	Mr. HUIZENGA	✓	
	Mr. DUFFY	✓	
	Mr. STIVERS	✓	
	Mr. HULTGREN	✓	
	Mr. ROSS	✓	
	Mr. PITTENGER	✓	
	Mrs. WAGNER	✓	
	Mr. BARR	✓	
	Mr. ROTHFUS	✓	
	Mr. MESSER	✓	
	Mr. TIPTON	✓	
	Mr. WILLIAMS	✓	
	Mr. POLIQUIN	✓	
	Mrs. LOVE	✓	
	Mr. HILL	✓	
	Mr. EMMER	✓	
	Mr. ZELDIN	✓	
	Mr. TROTT	✓	
	Mr. LOUDERMILK	✓	
	Mr. MOONEY	✓	
	Mr. MACARTHUR	✓	
	Mr. DAVIDSON	✓	
	Mr. BUDD	✓	
	Mr. KUSTOFF	✓	
	Ms. TENNEY	✓	
	Mr. HOLLINGSWORTH	✓	
	Ms. WATERS, <i>Ranking Member</i>		✓
	Mrs. MALONEY		✓
	Ms. VELÁZQUEZ		✓
	Mr. SHERMAN	✓	
	Mr. MEEKS	✓	
	Mr. CAPUANO		✓
	Mr. CLAY		✓
	Mr. LYNCH		✓
	Mr. SCOTT	✓	
	Mr. GREEN		✓
	Mr. CLEAVER		✓
	Ms. MOORE		✓
	Mr. ELLISON		✓
	Mr. PERLMUTTER	✓	
	Mr. HIMES	✓	
	Mr. FOSTER	✓	
	Mr. KILDEE		✓
	Mr. DELANEY	✓	
	Ms. SINEMA	✓	
	Mrs. BEATY		✓
	Mr. HECK		✓
	Mr. VARGAS	✓	
	Mr. GOTTHEIMER	✓	
	Mr. GONZALEZ	✓	
	Mr. CRIST		✓
	Mr. KIHUEN	✓	

## Committee on Financial Services

115<sup>th</sup> CongressDATE: 10/12/17Measure HR 3948Amendment No. MJA

Offered by: \_\_\_\_\_

Agreed To	Yes	No	Wdrn
	✓		

Voice Vote	Yeas	Nays	Prsnt
	46	14	

Record vote no. FC-94

As Amended

## 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. 3948 will prevent the SEC from mandating that companies turnover their source code and other intellectual property without a subpoena.

## 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.

## 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, February 8, 2018.*

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. 3948, the Protection of Source Code Act.

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,  
*Director.*

Enclosure.

*H.R. 3948—Protection of Source Code Act*

H.R. 3948 would require the Securities and Exchange Commission (SEC) to issue a subpoena before it could compel people or entities that are regulated under various securities laws to provide their algorithmic trading source code to the agency.

Using information from the SEC, CBO estimates that implementing H.R. 3948 would require the agency to spend less than \$500,000 to update its guidance documents. Moreover, the SEC is authorized to collect fees sufficient to offset its annual appropria-

tion; therefore, CBO estimates that the net effect on discretionary spending would be negligible, assuming appropriation actions consistent with that authority.

Enacting H.R. 3948 would not affect direct spending or revenues; therefore, pay-as-you-go procedures do not apply.

CBO estimates that enacting H.R. 3948 would not increase net direct spending or on-budget deficits in any of the four consecutive 10-year periods beginning in 2028.

H.R. 3948 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act.

The CBO staff contact for this estimate is Stephen Rabent. The estimate was approved by H. Samuel Papenfuss, Deputy Assistant Director for Budget Analysis.

#### FEDERAL MANDATES STATEMENT

This information is provided in accordance with section 423 of the Unfunded Mandates Reform Act of 1995.

The Committee has determined that the bill does not contain Federal mandates on the private sector. The Committee has determined that the bill does not impose a Federal intergovernmental mandate on State, local, or tribal governments.

#### 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

With respect to clause 9 of rule XXI of the Rules of the House of Representatives, the Committee has carefully reviewed the provisions of the bill and states that the provisions of the bill do not contain any congressional earmarks, limited tax benefits, or limited tariff benefits within the meaning of the rule.

#### DUPLICATION OF FEDERAL PROGRAMS

In compliance with clause 3(c)(5) of rule XIII of the Rules of the House of Representatives, the Committee states that no provision of the bill establishes or reauthorizes: (1) a program of the Federal Government known to be duplicative of another Federal program; (2) a program included in any report from the Government Accountability Office to Congress pursuant to section 21 of Public Law 111-139; or (3) a program related to a program identified in the most recent Catalog of Federal Domestic Assistance, published pursuant to the Federal Program Information Act (Pub. L. No. 95-220, as amended by Pub. L. No. 98-169).

## DISCLOSURE OF DIRECTED RULEMAKING

Pursuant to section 3(i) of H. Res. 5, (115th Congress), the following statement is made concerning directed rulemakings: The Committee estimates that the bill requires no directed rulemakings within the meaning of such section.

## SECTION-BY-SECTION ANALYSIS OF THE LEGISLATION

*Section 1. Short title*

This section cites H.R. 3948 as the "Protection of Source Code Act."

*Section 2. Procedure for obtaining certain intellectual property*

This section amends the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, and the Investment Advisers Act of 1940 such that each states the SEC is not allowed to require the turnover of source code and similar intellectual property unless the Commission first issues a subpoena.

## 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 omitted is enclosed in black brackets, new matter is printed in italic, and existing law in which no change is proposed is shown in roman):

## 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 omitted is enclosed in black brackets, new matter is printed in italic, and existing law in which no change is proposed is shown in roman):

**SECURITIES ACT OF 1933**

## TITLE I—

\* \* \* \* \*

TAKING EFFECT OF REGISTRATION STATEMENTS AND AMENDMENTS  
THERE TO

SEC. 8. (a) Except as hereinafter provided, the effective date of a registration statement shall be the twentieth day after the filing thereof or such earlier date as the Commission may determine, having due regard to the adequacy of the information respecting the issuer theretofore available to the public, to the facility with which the nature of the securities to be registered, their relationship to the capital structure of the issuer and the rights of holders thereof can be understood, and to the public interest and the protection of investors. If any amendment to any such statement is filed prior to the effective date of such statement, the registration

statement shall be deemed to have been filed when such amendment was filed; except that an amendment filed with the consent of the Commission, prior to the effective date of the registration statement, or filed pursuant to an order of the Commission, shall be treated as a part of the registration statement.

(b) If it appears to the Commission that a registration statement is on its face incomplete or inaccurate in any material respect, the Commission may, after notice by personal service or the sending of confirmed telegraphic notice not later than ten days after the filing of the registration statement, and opportunity for hearing (at a time fixed by the Commission) within ten days after such notice by personal service or the sending of such telegraphic notice, issue an order prior to the effective date of registration refusing to permit such statement to become effective until it has been amended in accordance with such order. When such statement has been amended in accordance with such order the Commission shall so declare and the registration shall become effective at the time provided in subsection (a) or upon the date of such declaration, whichever date is the later.

(c) An amendment filed after the effective date of the registration statement, if such amendment, upon its face, appears to the Commission not to be incomplete or inaccurate in any material respect, shall become effective on such date as the Commission may determine, having due regard to the public interest and the protection of investors.

(d) If it appears to the Commission at any time that the registration statement includes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading, the Commission may, after notice by personal service or the sending of confirmed telegraphic notice, and after opportunity for hearing (at a time fixed by the Commission) within fifteen days after such notice by personal service or the sending of such telegraphic notice, issue a stop order suspending the effectiveness of the registration statement. When such statement has been amended in accordance with such stop order the Commission shall so declare and thereupon the stop order shall cease to be effective.

(e) The Commission is hereby empowered to make an examination in any case in order to determine whether a stop order should issue under subsection (d). In making such examination the Commission or any officer or officers designated by it shall have access to and may demand the production of any books and papers of, and may administer oaths and affirmations to and examine, the issuer, underwriter, or any other person, in respect of any matter relevant to the examination, and may, in its discretion, require the production of a balance sheet exhibiting the assets and liabilities of the issuer, or its income statement, or both, to be certified to by a public or certified accountant approved by the Commission. If the issuer or underwriter shall fail to cooperate, or shall obstruct or refuse to permit the making of an examination, such conduct shall be proper ground for the issuance of a stop order.

(f) Any notice required under this section shall be sent to or served on the issuer, or, in case of a foreign government or political subdivision thereof, to or on the underwriter, or, in the case of a foreign or Territorial person, to or on its duly authorized represent-



ative in the United States named in the registration statement, properly directed in each case of telegraphic notice to the address given in such statement.

(g) *PROCEDURE FOR OBTAINING CERTAIN INTELLECTUAL PROPERTY.*—*The Commission is not authorized to compel under this title a person to produce or furnish source code, including algorithmic trading source code or similar intellectual property that forms the basis for design of the source code, to the Commission unless the Commission first issues a subpoena.*

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## SECURITIES EXCHANGE ACT OF 1934

### TITLE I—REGULATION OF SECURITIES EXCHANGES

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#### RULES, REGULATIONS, AND ORDERS; ANNUAL REPORTS

SEC. 23. (a)(1) The Commission, the Board of Governors of the Federal Reserve System, and the other agencies enumerated in section 3(a)(34) of this title shall each have power to make such rules and regulations as may be necessary or appropriate to implement the provisions of this title for which they are responsible or for the execution of the functions vested in them by this title, and may for such purposes classify persons, securities, transactions, statements, applications, reports, and other matters within their respective jurisdictions, and prescribe greater, lesser, or different requirements for different classes thereof. No provision of this title imposing any liability shall apply to any act done or omitted in good faith in conformity with a rule, regulation, or order of the Commission, the Board of Governors of the Federal Reserve System, other agency enumerated in section 3(a)(34) of this title, or any self-regulatory organization, notwithstanding that such rule, regulation, or order may thereafter be amended or rescinded or determined by judicial or other authority to be invalid for any reason.

(2) The Commission and the Secretary of the Treasury, in making rules and regulations pursuant to any provisions of this title, shall consider among other matters the impact any such rule or regulation would have on competition. The Commission and the Secretary of the Treasury shall not adopt any such rule or regulation which would impose a burden on competition not necessary or appropriate in furtherance of the purposes of this title. The Commission and the Secretary of the Treasury shall include in the statement of basis and purpose incorporated in any rule or regulation adopted under this title, the reasons for the Commission's or the Secretary's determination that any burden on competition imposed by such rule or regulation is necessary or appropriate in furtherance of the purposes of this title.

(3) The Commission and the Secretary, in making rules and regulations pursuant to any provision of this title, considering any application for registration in accordance with section 19(a) of this title, or reviewing any proposed rule change of a self-regulatory organization in accordance with section 19(b) of this title, shall keep in a public file and make available for copying all written state-

ments filed with the Commission and the Secretary and all written communications between the Commission or the Secretary and any person relating to the proposed rule, regulation, application, or proposed rule change: *Provided, however,* That the Commission and the Secretary shall not be required to keep in a public file or make available for copying any such statement or communication which it may withhold from the public in accordance with the provisions of section 552 of title 5, United States Code.

(b)(1) The Commission, the Board of Governors of the Federal Reserve System, and the other agencies enumerated in section 3(a)(34) of this title shall each make an annual report to the Congress on its work for the preceding year, and shall include in each such report whatever information, data, and recommendations for further legislation it considers advisable with regard to matters within its respective jurisdiction under this title.

(2) The appropriate regulatory agency for a self-regulatory organization shall include in its annual report to the Congress for each fiscal year, a summary of its oversight activities under this title with respect to such self-regulatory organization, including a description of any examination conducted as part of such activities of any organization, any material recommendation presented as part of such activities to such organization for changes in its organization or rules, and any such action by such organization in response to any such recommendation.

(3) The appropriate regulatory agency for any class of municipal securities dealers shall include in its annual report to the Congress for each fiscal year a summary of its regulatory activities pursuant to this title with respect to such municipal securities dealers, including the nature of and reason for any sanction imposed pursuant to this title against any such municipal securities dealer.

(4) The Commission shall also include in its annual report to the Congress for each fiscal year—

(A) a summary of the Commission's oversight activities with respect to self-regulatory organizations for which it is not the appropriate regulatory agency, including a description of any examination of any such organization, any material recommendation presented to any such organization for changes in its organization or rules, and any action by any such organization in response to any such recommendations;

(B) a statement and analysis of the expenses and operations of each self-regulatory organization in connection with the performance of its responsibilities under this title, for which purpose data pertaining to such expenses and operations shall be made available by such organization to the Commission at its request;

(C) the steps the Commission has taken and the progress it has made toward ending the physical movement of the securities certificate in connection with the settlement of securities transactions, and its recommendations, if any, for legislation to eliminate the securities certificate;

(D) the number of requests for exemptions from provisions of this title received, the number granted, and the basis upon which any such exemption was granted;

(E) a summary of the Commission's regulatory activities with respect to municipal securities dealers for which it is not the

appropriate regulatory agency, including the nature of, and reason for, any sanction imposed in proceedings against such municipal securities dealers;

(F) a statement of the time elapsed between the filing of reports pursuant to section 13(f) of this title and the public availability of the information contained therein, the costs involved in the Commission's processing of such reports and tabulating such information, the manner in which the Commission uses such information, and the steps the Commission has taken and the progress it has made toward requiring such reports to be filed and such information to be made available to the public in machine language;

(G) information concerning (i) the effects its rules and regulations are having on the viability of small brokers and dealers; (ii) its attempts to reduce any unnecessary reporting burden on such brokers and dealers; and (iii) its efforts to help to assure the continued participation of small brokers and dealers in the United States securities markets;

(H) a statement detailing its administration of the Freedom of Information Act, section 552 of title 5, United States Code, including a copy of the report filed pursuant to subsection (d) of such section; and

(I) the steps that have been taken and the progress that has been made in promoting the timely public dissemination and availability for analytical purposes (on a fair, reasonable, and nondiscriminatory basis) of information concerning government securities transactions and quotations, and its recommendations, if any, for legislation to assure timely dissemination of (i) information on transactions in regularly traded government securities sufficient to permit the determination of the prevailing market price for such securities, and (ii) reports of the highest published bids and lowest published offers for government securities (including the size at which persons are willing to trade with respect to such bids and offers).

(c) The Commission, by rule, shall prescribe the procedure applicable to every case pursuant to this title of adjudication (as defined in section 551 of title 5, United States Code) not required to be determined on the record after notice and opportunity for hearing. Such rules shall, as a minimum, provide that prompt notice shall be given of any adverse action or final disposition and that such notice and the entry of any order shall be accompanied by a statement of written reasons.

(d) CEASE-AND-DESIST PROCEDURES.—Within 1 year after the date of enactment of this subsection, the Commission shall establish regulations providing for the expeditious conduct of hearings and rendering of decisions under section 21C of this title, section 8A of the Securities Act of 1933, section 9(f) of the Investment Company Act of 1940, and section 203(k) of the Investment Advisers Act of 1940.

(e) *PROCEDURE FOR OBTAINING CERTAIN INTELLECTUAL PROPERTY.*—*The Commission is not authorized to compel under this title a person to produce or furnish source code, including algorithmic trading source code or similar intellectual property that forms the*

*basis for design of the source code, to the Commission unless the Commission first issues a subpoena.*

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## INVESTMENT COMPANY ACT OF 1940

### TITLE I—INVESTMENT COMPANIES

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#### ACCOUNTS AND RECORDS

##### SEC. 31. (a) MAINTENANCE OF RECORDS.—

(1) **IN GENERAL.**—Each registered investment company, and each underwriter, broker, dealer, or investment adviser that is a majority-owned subsidiary of such a company, shall maintain and preserve such records (as defined in section 3(a)(37) of the Securities Exchange Act of 1934) for such period or periods as the Commission, by rules and regulations, may prescribe as necessary or appropriate in the public interest or for the protection of investors. Each investment adviser that is not a majority-owned subsidiary of, and each depositor of any registered investment company, and each principal underwriter for any registered investment company other than a closed-end company, shall maintain and preserve for such period or periods as the Commission shall prescribe by rules and regulations, such records as are necessary or appropriate to record such person's transactions with such registered company. Each person having custody or use of the securities, deposits, or credits of a registered investment company shall maintain and preserve all records that relate to the custody or use by such person of the securities, deposits, or credits of the registered investment company for such period or periods as the Commission, by rule or regulation, may prescribe, as necessary or appropriate in the public interest or for the protection of investors.

(2) **MINIMIZING COMPLIANCE BURDEN.**—In exercising its authority under this subsection, the Commission shall take such steps as it deems necessary or appropriate, consistent with the public interest and for the protection of investors, to avoid unnecessary recordkeeping by, and minimize the compliance burden on, persons required to maintain records under this subsection (hereafter in this section referred to as “subject persons”). Such steps shall include considering, and requesting public comment on—

(A) feasible alternatives that minimize the recordkeeping burdens on subject persons;

(B) the necessity of such records in view of the public benefits derived from the independent scrutiny of such records through Commission examination;

(C) the costs associated with maintaining the information that would be required to be reflected in such records; and

(D) the effects that a proposed recordkeeping requirement would have on internal compliance policies and procedures.

(b) EXAMINATIONS OF RECORDS.—

(1) IN GENERAL.—All records required to be maintained and preserved in accordance with subsection (a) shall be subject at any time and from time to time to such reasonable periodic, special, and other examinations by the Commission, or any member or representative thereof, as the Commission may prescribe.

(2) AVAILABILITY.—For purposes of examinations referred to in paragraph (1), any subject person shall make available to the Commission or its representatives any copies or extracts from such records as may be prepared without undue effort, expense, or delay as the Commission or its representatives may reasonably request.

(3) COMMISSION ACTION.—The Commission shall exercise its authority under this subsection with due regard for the benefits of internal compliance policies and procedures and the effective implementation and operation thereof.

(4) RECORDS OF PERSONS WITH CUSTODY OR USE.—

(A) IN GENERAL.—Records of persons having custody or use of the securities, deposits, or credits of a registered investment company that relate to such custody or use, are subject at any time, or from time to time, to such reasonable periodic, special, or other examinations and other information and document requests by representatives of the Commission, as the Commission deems necessary or appropriate in the public interest or for the protection of investors.

(B) CERTAIN PERSONS SUBJECT TO OTHER REGULATION.—Any person that is subject to regulation and examination by a Federal financial institution regulatory agency (as such term is defined under section 212(c)(2) of title 18, United States Code) may satisfy any examination request, information request, or document request described under subparagraph (A), by providing to the Commission a detailed listing, in writing, of the securities, deposits, or credits of the registered investment company within the custody or use of such person.

(c) REGULATORY AUTHORITY.—The Commission may, in the public interest or for the protection of investors, issue rules and regulations providing for a reasonable degree of uniformity in the accounting policies and principles to be followed by registered investment companies in maintaining their accounting records and in preparing financial statements required pursuant to this title.

(d) EXEMPTION AUTHORITY.—The Commission, upon application made by any registered investment company, may by order exempt a specific transaction or transactions from the provisions of any rule or regulation made pursuant to subsection (e), if the Commission finds that such rule or regulation should not reasonably be applied to such transaction.

(e) PROCEDURE FOR OBTAINING CERTAIN INTELLECTUAL PROPERTY.—*The Commission is not authorized to compel under this title an investment company to produce or furnish source code, including*

*algorithmic trading source code or similar intellectual property that forms the basis for design of the source code, to the Commission unless the Commission first issues a subpoena.*

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## INVESTMENT ADVISERS ACT OF 1940

### TITLE II—INVESTMENT ADVISERS

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#### ANNUAL AND OTHER REPORTS

SEC. 204. (a) IN GENERAL.—Every investment adviser who makes use of the mails or of any means or instrumentality of interstate commerce in connection with his or its business as an investment adviser (other than one specifically exempted from registration pursuant to section 203(b) of this title), shall make and keep for prescribed periods such records (as defined in section 3(a)(37) of the Securities Exchange Act of 1934), furnish such copies thereof, and make and disseminate such reports as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors. All records (as so defined) of such investment advisers are subject at any time, or from time to time, to such reasonable periodic, special, or other examinations by representatives of the Commission as the Commission deems necessary or appropriate in the public interest or for the protection of investors.

(b) RECORDS AND REPORTS OF PRIVATE FUNDS.—

(1) IN GENERAL.—The Commission may require any investment adviser registered under this title—

(A) to maintain such records of, and file with the Commission such reports regarding, private funds advised by the investment adviser, as necessary and appropriate in the public interest and for the protection of investors, or for the assessment of systemic risk by the Financial Stability Oversight Council (in this subsection referred to as the “Council”); and

(B) to provide or make available to the Council those reports or records or the information contained therein.

(2) TREATMENT OF RECORDS.—The records and reports of any private fund to which an investment adviser registered under this title provides investment advice shall be deemed to be the records and reports of the investment adviser.

(3) REQUIRED INFORMATION.—The records and reports required to be maintained by an investment adviser and subject to inspection by the Commission under this subsection shall include, for each private fund advised by the investment adviser, a description of—

(A) the amount of assets under management and use of leverage, including off-balance-sheet leverage;

(B) counterparty credit risk exposure;

(C) trading and investment positions;

(D) valuation policies and practices of the fund;

(E) types of assets held;

(F) side arrangements or side letters, whereby certain investors in a fund obtain more favorable rights or entitlements than other investors;

(G) trading practices; and

(H) such other information as the Commission, in consultation with the Council, determines is necessary and appropriate in the public interest and for the protection of investors or for the assessment of systemic risk, which may include the establishment of different reporting requirements for different classes of fund advisers, based on the type or size of private fund being advised.

(4) MAINTENANCE OF RECORDS.—An investment adviser registered under this title shall maintain such records of private funds advised by the investment adviser for such period or periods as the Commission, by rule, may prescribe as necessary and appropriate in the public interest and for the protection of investors, or for the assessment of systemic risk.

(5) FILING OF RECORDS.—The Commission shall issue rules requiring each investment adviser to a private fund to file reports containing such information as the Commission deems necessary and appropriate in the public interest and for the protection of investors or for the assessment of systemic risk.

(6) EXAMINATION OF RECORDS.—

(A) PERIODIC AND SPECIAL EXAMINATIONS.—The Commission—

(i) shall conduct periodic inspections of the records of private funds maintained by an investment adviser registered under this title in accordance with a schedule established by the Commission; and

(ii) may conduct at any time and from time to time such additional, special, and other examinations as the Commission may prescribe as necessary and appropriate in the public interest and for the protection of investors, or for the assessment of systemic risk.

(B) AVAILABILITY OF RECORDS.—An investment adviser registered under this title shall make available to the Commission any copies or extracts from such records as may be prepared without undue effort, expense, or delay, as the Commission or its representatives may reasonably request.

(7) INFORMATION SHARING.—

(A) IN GENERAL.—The Commission shall make available to the Council copies of all reports, documents, records, and information filed with or provided to the Commission by an investment adviser under this subsection as the Council may consider necessary for the purpose of assessing the systemic risk posed by a private fund.

(B) CONFIDENTIALITY.—The Council shall maintain the confidentiality of information received under this paragraph in all such reports, documents, records, and information, in a manner consistent with the level of confidentiality established for the Commission pursuant to paragraph (8). The Council shall be exempt from section 552 of title 5, United States Code, with respect to any informa-

tion in any report, document, record, or information made available, to the Council under this subsection.

(8) COMMISSION CONFIDENTIALITY OF REPORTS.—Notwithstanding any other provision of law, the Commission may not be compelled to disclose any report or information contained therein required to be filed with the Commission under this subsection, except that nothing in this subsection authorizes the Commission—

(A) to withhold information from Congress, upon an agreement of confidentiality; or

(B) prevent the Commission from complying with—

(i) a request for information from any other Federal department or agency or any self-regulatory organization requesting the report or information for purposes within the scope of its jurisdiction; or

(ii) an order of a court of the United States in an action brought by the United States or the Commission.

(9) OTHER RECIPIENTS CONFIDENTIALITY.—Any department, agency, or self-regulatory organization that receives reports or information from the Commission under this subsection shall maintain the confidentiality of such reports, documents, records, and information in a manner consistent with the level of confidentiality established for the Commission under paragraph (8).

(10) PUBLIC INFORMATION EXCEPTION.—

(A) IN GENERAL.—The Commission, the Council, and any other department, agency, or self-regulatory organization that receives information, reports, documents, records, or information from the Commission under this subsection, shall be exempt from the provisions of section 552 of title 5, United States Code, with respect to any such report, document, record, or information. Any proprietary information of an investment adviser ascertained by the Commission from any report required to be filed with the Commission pursuant to this subsection shall be subject to the same limitations on public disclosure as any facts ascertained during an examination, as provided by section 210(b) of this title.

(B) PROPRIETARY INFORMATION.—For purposes of this paragraph, proprietary information includes sensitive, non-public information regarding—

(i) the investment or trading strategies of the investment adviser;

(ii) analytical or research methodologies;

(iii) trading data;

(iv) computer hardware or software containing intellectual property; and

(v) any additional information that the Commission determines to be proprietary.

(11) ANNUAL REPORT TO CONGRESS.—The Commission shall report annually to Congress on how the Commission has used the data collected pursuant to this subsection to monitor the markets for the protection of investors and the integrity of the markets.



(c) **FILING DEPOSITORIES.**—The Commission may, by rule, require an investment adviser—

(1) to file with the Commission any fee, application, report, or notice required to be filed by this title or the rules issued under this title through any entity designated by the Commission for that purpose; and

(2) to pay the reasonable costs associated with such filing and the establishment and maintenance of the systems required by subsection (c).

(d) **ACCESS TO DISCIPLINARY AND OTHER INFORMATION.**—

(1) **MAINTENANCE OF SYSTEM TO RESPOND TO INQUIRIES.**—

(A) **IN GENERAL.**—The Commission shall require the entity designated by the Commission under subsection (b)(1) to establish and maintain a toll-free telephone listing, or a readily accessible electronic or other process, to receive and promptly respond to inquiries regarding registration information (including disciplinary actions, regulatory, judicial, and arbitration proceedings, and other information required by law or rule to be reported) involving investment advisers and persons associated with investment advisers.

(B) **APPLICABILITY.**—This subsection shall apply to any investment adviser (and the persons associated with that adviser), whether the investment adviser is registered with the Commission under section 203 or regulated solely by a State, as described in section 203A.

(2) **RECOVERY OF COSTS.**—An entity designated by the Commission under subsection (b)(1) may charge persons making inquiries, other than individual investors, reasonable fees for responses to inquiries described in paragraph (1).

(3) **LIMITATION ON LIABILITY.**—An entity designated by the Commission under subsection (b)(1) shall not have any liability to any person for any actions taken or omitted in good faith under this subsection.

**[(d)] (e) RECORDS OF PERSONS WITH CUSTODY OR USE.**—

(1) **IN GENERAL.**—Records of persons having custody or use of the securities, deposits, or credits of a client, that relate to such custody or use, are subject at any time, or from time to time, to such reasonable periodic, special, or other examinations and other information and document requests by representatives of the Commission, as the Commission deems necessary or appropriate in the public interest or for the protection of investors.

(2) **CERTAIN PERSONS SUBJECT TO OTHER REGULATION.**—Any person that is subject to regulation and examination by a Federal financial institution regulatory agency (as such term is defined under section 212(c)(2) of title 18, United States Code) may satisfy any examination request, information request, or document request described under paragraph (1), by providing the Commission with a detailed listing, in writing, of the securities, deposits, or credits of the client within the custody or use of such person.

(f) **PROCEDURE FOR OBTAINING CERTAIN INTELLECTUAL PROPERTY.**—*The Commission is not authorized to compel under this title an investment adviser to produce or furnish source code, including*

*algorithmic trading source code or similar intellectual property that forms the basis for design of the source code, to the Commission unless the Commission first issues a subpoena.*

\* \* \* \* \*

## MINORITY VIEWS

H.R. 3948 would severely hamper the ability of the Securities and Exchange Commission (SEC) to effectively conduct compliance examinations and investigate computer-driven market disruptions. Specifically, this bill imposes an overly broad and unwarranted subpoena requirement before SEC staff could inspect a wide array of routine business records involving source code and related information.

Although H.R. 3948 is offered under the guise of due process and intellectual property protections, the bill represents a gift for hedge funds and high-frequency traders (HFTs) seeking to avoid regulatory oversight of their potentially disruptive automated trading systems. As history shows, the unfettered use of these systems could jeopardize the stability of U.S. capital markets. For example, on May 6, 2010, in an event referred to as the “Flash Crash,” major U.S. stock indices plummeted nearly \$1 trillion in less than an hour before partially rebounding. The SEC and the Commodity Futures Trading Commission (CFTC) took an alarming five months to investigate the incident and determined that it was caused by a combination of a flawed execution algorithm of one institutional investor and aggressive algorithmic trading by HFTs.

In response to the Flash Crash, the SEC and other regulators have worked to improve their ability to quickly discover the cause of technology-based interference with U.S. capital markets. H.R. 3948 would undermine the SEC’s efforts in favor of the very parties responsible for the Flash Crash by erecting procedural hurdles to Staff’s access to algorithmic trading data.

Moreover, H.R. 3948’s subpoena requirement would extend far beyond algorithmic trading data to source code of any kind, as well as a host of related data that does not constitute source code. This information is routinely included in firms’ books and records, which the SEC reviews in order to evaluate compliance with regulations designed to protect investors and facilitate market integrity. For example, this bill would prohibit the SEC’s compliance examination staff from inspecting computer code relating to a firm’s cybersecurity controls without first referring the matter to the Enforcement Division or obtaining a subpoena by majority vote of the SEC’s Commissioners.

The bill was amended in Committee to strike language extending the subpoena requirement to intellectual property that “provides insight to” source code. However, even as amended, this deeply flawed and shortsighted bill would imperil market stability to the detriment of investors.

Several stakeholders wrote to the Committee to oppose H.R. 3948 on the grounds that it would dangerously limit oversight of technology that has gained an increased significance in our capital markets. These stakeholders include investor advocacy groups like

Americans for Financial Reform, Center for American Progress, Consumer Federation of America, and Public Citizen.

The Minority believes that Congress should work to enhance the ability of our regulators to conduct effective oversight for the protection of investors and the stability of our markets. H.R. 3948 is an irresponsible bill that does just the opposite.

For these reasons, the Minority opposes H.R. 3948.

MAXINE WATERS.  
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EMMANUEL CLEAVER.  
NYDIA M. VELÁZQUEZ.  
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AL GREEN.  
WM. LACY CLAY.  
STEPHEN LYNCH.  
VICENTE GONZALEZ.

