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1ST SESSION

# H. R. 2420

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IN THE SENATE OF THE UNITED STATES

NOVEMBER 20, 2003

Received; read twice and referred to the Committee on Banking, Housing, and  
Urban Affairs

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## AN ACT

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,*

1 **SECTION 1. SHORT TITLE.**

2 (a) SHORT TITLE.—This Act may be cited as the  
3 “Mutual Funds Integrity and Fee Transparency Act of  
4 2003”.

5 (b) TABLE OF CONTENTS.—

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6 **TITLE I—INTEGRITY AND FEE**  
7 **TRANSPARENCY**

8 **SEC. 101. IMPROVED TRANSPARENCY OF MUTUAL FUND**  
9 **COSTS.**

10 (a) REGULATION REVISION REQUIRED.—Within 270  
11 days after the date of enactment of this Act, the Securities  
12 and Exchange Commission shall revise regulations under  
13 the Securities Act of 1933, the Securities Exchange Act  
14 of 1934, or the Investment Company Act of 1940, or any

1 combination thereof, to require, consistent with the protec-  
2 tion of investors and the public interest, improved disclo-  
3 sure with respect to an open-end management investment  
4 company, in the quarterly statement or other periodic re-  
5 port to shareholders or other appropriate disclosure docu-  
6 ment, of the following:

7           (1) The estimated amount, in dollars for each  
8       \$1,000 of investment in the company, of the oper-  
9       ating expenses of the company that are borne by  
10      shareholders.

11          (2) The structure of, or method used to deter-  
12      mine, the compensation of individuals employed by  
13      the investment adviser of the company to manage  
14      the portfolio of the company, and the ownership in-  
15      terest of such individuals in the securities of the  
16      company.

17          (3) The portfolio turnover rate of the company,  
18      set forth in a manner that facilitates comparison  
19      among investment companies, and a description of  
20      the implications of a high turnover rate for portfolio  
21      transaction costs and performance.

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) APPROPRIATE DISCLOSURE DOCUMENT.—

22 (1) IN GENERAL.—For purposes of subsection  
23 (a), a disclosure shall not be considered to be made  
24 in an appropriate disclosure document if the disclo-  
25 sure is made exclusively in a prospectus or state-

1       ment of additional information, or both such docu-  
2       ments.

3           (2) EXCEPTIONS.—Notwithstanding paragraph  
4       (1), the disclosures required by paragraph (2) and  
5       (4) of subsection (a) may be considered to be made  
6       in an appropriate disclosure document if the disclo-  
7       sure is made exclusively in a prospectus or state-  
8       ment of additional information, or both such docu-  
9       ments.

10       (c) CONCEPT RELEASE REQUIRED.—

11           (1) IN GENERAL.—The Commission shall issue  
12       a concept release examining the issue of portfolio  
13       transaction costs incurred by investment companies,  
14       including commission, spread, opportunity, and mar-  
15       ket impact costs, with respect to trading of portfolio  
16       securities and how such costs may be disclosed to  
17       mutual fund investors in a manner that will enable  
18       investors to compare such costs among funds.

19           (2) REPORT AND RECOMMENDATIONS RE-  
20       QUIRED.—The Commission shall submit a report on  
21       the findings from the concept release required by  
22       paragraph (1), as well as legislative and regulatory  
23       recommendations, if any, to the Committee on Fi-  
24       nancial Services of the House of Representatives and  
25       the Committee on Banking, Housing, and Urban Af-

1       fairs of the Senate, no later than 270 days after the  
2       date of enactment of this Act.

3       (d) ADDITIONAL REQUIREMENT FOR FEE STATE-  
4       MENT.—

5               (1) IN GENERAL.—Not later than 270 days  
6       after the date of enactment of this Act, the Commis-  
7       sion shall prescribe a rule to require, with respect to  
8       an open-end management investment company, in  
9       the quarterly statement or other periodic report, or  
10      other appropriate disclosure document, a statement  
11      informing shareholders that such shareholders have  
12      paid fees on their investments, that such fees have  
13      been deducted from the amounts shown on the state-  
14      ments, and where such shareholders may find addi-  
15      tional information regarding the amount of these  
16      fees.

17              (2) APPROPRIATE DISCLOSURE DOCUMENT.—  
18      The statement required by paragraph (1) shall not  
19      be considered to be made in an appropriate disclo-  
20      sure document unless such statement is—

21                      (A) made in each periodic statement to a  
22                      shareholder that discloses the value of the hold-  
23                      ings of the shareholder in the securities of the  
24                      company; and

1 (B) prominently displayed, in a location in  
 2 close proximity to the statement of the shares  
 3 account value.

4 (e) REDUCING BURDENS ON SMALL FUNDS.—In pre-  
 5 scribing rules under this section, the Commission shall  
 6 give consideration to methods for reducing for small in-  
 7 vestment companies the burdens of making the disclosures  
 8 required by such rules, consistent with the public interest  
 9 and the protection of investors.

10 **SEC. 102. OBLIGATIONS REGARDING CERTAIN DISTRIBUTION AND SOFT DOLLAR ARRANGEMENTS.**

12 (a) REPORTING REQUIREMENT.—Section 15 of the  
 13 Investment Company Act of 1940 (15 U.S.C. 80a–15) is  
 14 amended by adding at the end the following new sub-  
 15 section:

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

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

22 “(A) payments during the reporting period  
 23 by the adviser (or an affiliated person of the  
 24 adviser) that were directly or indirectly made  
 25 for the purpose of promoting the sale of shares

of the investment company (referred to in paragraph (2) as a ‘revenue sharing arrangement’);

“(B) services to the company provided or paid for by a broker or dealer or an affiliated person of the broker or dealer (other than brokerage and research services) in exchange for the direction of brokerage to the broker or dealer (referred to in paragraph (2) as a ‘directed brokerage arrangement’); and

“(C) research services obtained by the adviser (or an affiliated person of the adviser) during the reporting period from a broker or dealer the receipt of which may reasonably be attributed to securities transactions effected on behalf of the company or any other company that is a member of the same group of investment companies (referred to in paragraph (2) as a ‘soft dollar arrangement’).

“(2) FIDUCIARY DUTY OF BOARD OF DIRECTORS.—The board of directors of a registered investment company shall have a fiduciary duty—

“(A) to review the investment adviser’s direction of the company’s brokerage transactions, including directed brokerage arrangements and soft dollar arrangements, and to de-



1           termine that the direction of such brokerage is  
2           in the best interests of the shareholders of the  
3           company; and

4           “(B) to review any revenue sharing ar-  
5           rangements to ensure compliance with this Act  
6           and the rules adopted thereunder, and to deter-  
7           mine that such revenue sharing arrangements  
8           are in the best interests of the shareholders of  
9           the company.

10          “(3) SUMMARIES OF REPORTS IN ANNUAL RE-  
11          PORTS TO SHAREHOLDERS.—In accordance with reg-  
12          ulations prescribed by the Commission under para-  
13          graph (4), annual reports to shareholders of a reg-  
14          istered investment company shall include a summary  
15          of the most recent report submitted to the board of  
16          directors under paragraph (1).

17          “(4) REGULATIONS.—The Commission shall  
18          adopt rules and regulations implementing this sec-  
19          tion, which rules and regulations shall, among other  
20          things, prescribe the content of the required reports.

21          “(5) DEFINITION.—For purposes of this sub-  
22          section—

23                 “(A) the term ‘brokerage and research  
24                 services’ has the same meaning as in section

1           28(e)(3) of the Securities Exchange Act of  
2           1934; and

3           “(B) the term ‘research services’ means  
4           the services described in subparagraphs (A) and  
5           (B) of such section.”.

6           (b) CONTRACTUAL RECORDS.—Within 270 days after  
7           the date of enactment of this Act, the Securities and Ex-  
8           change Commission shall, by rule prescribed pursuant to  
9           section 28(e) of the Securities Exchange Act of 1934 (15  
10          U.S.C. 78bb(e)), require that—

11           (1) if any research services (as such term is de-  
12           fined in section 15(g)(5)(B) of the Investment Com-  
13           pany Act of 1940, as amended by subsection (a) of  
14           this section)—

15           (A) are provided by a member of an ex-  
16           change, broker, or dealer who effects securities  
17           transactions in an account, and

18           (B) are prepared or provided by a party  
19           that is unaffiliated with such member, broker,  
20           or dealer,

21           any person exercising investment discretion with re-  
22           spect to such account shall maintain a copy of the  
23           written contract between the person preparing such  
24           research and the member of an exchange, broker, or  
25           dealer; and

1           (2) such contract shall describe the nature and  
2           value of the services provided.

3 **SEC. 103. MUTUAL FUND GOVERNANCE.**

4           (a) DIRECTOR INDEPENDENCE.—Section 10(a) of  
5 the Investment Company Act of 1940 (15 U.S.C. 80a–  
6 10) is amended by striking “60 per centum” and inserting  
7 “one-third”.

8           (b) DEFINITION OF INTERESTED PERSON.—Section  
9 2(a)(19) of the Investment Company Act of 1940 (15  
10 U.S.C. 80a–2(a)(19)) is amended—

11           (1) in subparagraph (A)—

12                   (A) by striking clause (vi) and redesignig-  
13                   nating clause (vii) as clause (vi); and

14                   (B) by amending clause (v) to read as fol-  
15                   lows:

16                           “(v) any natural person who is a  
17                           member of a class of persons who the  
18                           Commission, by rule or regulation, deter-  
19                           mines are unlikely to exercise an appro-  
20                           priate degree of independence as a result  
21                           of—

22                                   “(I) a material business or pro-  
23                                   fessional relationship with the com-  
24                                   pany or any affiliated person of the  
25                                   company, or

1 “(II) a close familial relationship  
2 with any natural person who is an af-  
3 filiated person of the company,”; and

4 (2) in subparagraph (B)—

5 (A) by striking clause (vi) and redesign-  
6 ating clause (vii) as clause (vi); and

7 (B) by amending clause (v) to read as fol-  
8 lows:

9 “(v) any natural person who is a  
10 member of a class of persons who the  
11 Commission, by rule or regulation, deter-  
12 mines are unlikely to exercise an appro-  
13 priate degree of independence as a result  
14 of—

15 “(I) a material business or pro-  
16 fessional relationship with such invest-  
17 ment adviser or principal underwriter  
18 (or affiliated person thereof), or

19 “(II) a close familial relationship  
20 with a natural person who is such in-  
21 vestment adviser or principal under-  
22 writer (or affiliated person thereof),”.

1 **SEC. 104. AUDIT COMMITTEE REQUIREMENTS FOR INVEST-**  
2 **MENT COMPANIES.**

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

5 (1) in subsection (a)—

6 (A) by striking paragraphs (1) and (2) and  
7 inserting the following:

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

14 “(2) such selection shall have been submitted  
15 for ratification or rejection at the next succeeding  
16 annual meeting of stockholders if such meeting be  
17 held, except that any vacancy occurring between an-  
18 nual meetings, due to the death or resignation of the  
19 accountant, may be filled by the vote of a majority  
20 of the members of the audit committee of such reg-  
21 istered company, cast in person at a meeting called  
22 for the purpose of voting on such action;” and

23 (B) by adding at the end the following new  
24 sentence: “The Commission, by rule, regulation,  
25 or order, may exempt a registered management  
26 company or registered face-amount certificate

1 company subject to this subsection from the re-  
2 quirement in paragraph (1) that the votes by  
3 the members of the audit committee be cast at  
4 a meeting in person when such a requirement  
5 is impracticable, subject to such conditions as  
6 the Commission may require.”; and

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

9 “(d) AUDIT COMMITTEE REQUIREMENTS.—

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

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

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

7 “(3) INDEPENDENCE.—

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

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

19 “(i) accept any consulting, advisory,  
20 or other compensatory fee from the reg-  
21 istered company or the investment adviser  
22 or principal underwriter of the registered  
23 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 investment adviser or principal under-  
13 writer of concerns regarding questionable ac-  
14 counting or auditing matters.

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

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



1           “(A) to the independent public accountant  
2           employed by the registered company for the  
3           purpose of rendering or issuing the audit re-  
4           port; and

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

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

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

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

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

21          “(7) EXEMPTION FOR INVESTMENT COMPA-  
22          NIES.—Effective one year after the date of enact-  
23          ment of the Mutual Funds Integrity and Fee Trans-  
24          parency Act of 2003, for purposes of this subsection,  
25          the term ‘issuer’ shall not include any investment

1 company that is registered under section 8 of the In-  
 2 vestment Company Act of 1940.”.

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

8 **SEC. 105. TRADING RESTRICTIONS.**

9 Subsection (e) of section 22 of the Investment Com-  
 10 pany Act of 1940 (15 U.S.C. 80a–22(e)) is amended to  
 11 read as follows:

12 “(e) TRADING RESTRICTIONS.—

13 “(1) PROHIBITION AND EXCEPTIONS.—No reg-  
 14 istered investment company shall suspend the right  
 15 of redemption, or postpone the date of payment or  
 16 satisfaction upon redemption of any redeemable se-  
 17 curity in accordance with its terms for more than  
 18 seven days after the tender of such security to the  
 19 company or its agents designated for that purpose  
 20 for redemption, except—

21 “(A) for any period (i) during which the  
 22 principal market for the securities in which the  
 23 company invests is closed, other than customary  
 24 week-end and holiday closings; or (ii) during  
 25 which trading on such exchange is restricted;

“(B) for any period during which an emergency exists as a result of which (i) disposal by the company of securities owned by it is not reasonably practicable; or (ii) it is not reasonably practicable for such company fairly to determine the value of its net assets; or

“(C) for such other periods as the Commission may by order permit for the protection of security holders of the company.

“(2) COMMISSION RULES.—The Commission shall by rules and regulations—

“(A) determine the conditions under which trading shall be deemed to be restricted;

“(B) determine the conditions under which an emergency shall be deemed to exist; and

“(C) provide for the determination by each company, subject to such limitations as the Commission shall determine are necessary and appropriate for the protection of investors, of the principal market for the securities in which the company invests.”.

**SEC. 106. DEFINITION OF NO-LOAD MUTUAL FUND.**

Within 270 days after the date of enactment of this Act, the Securities and Exchange Commission shall, by

1 rule adopted by the Commission or a self-regulatory orga-  
2 nization (or both)—

3 (1) clarify the definition of “no-load” as such  
4 term is used by investment companies that impose  
5 any fee under a plan adopted pursuant to rule 12b-  
6 1 of the Commission’s rules (17 C.F.R. 270.12b–1);  
7 and

8 (2) require disclosure to prevent investors from  
9 being misled by the use of such terminology by the  
10 company or its adviser or principal underwriter.

11 **SEC. 107. INFORMING DIRECTORS OF SIGNIFICANT DEFICIENCIES.**  
12

13 Section 42 of the Investment Company Act of 1940  
14 (15 U.S.C. 80a–41) is amended by adding at the end the  
15 following new subsection:

16 “(f) INFORMING DIRECTORS OF SIGNIFICANT DEFICIENCIES.—If the report of an inspection by the Commis-  
17 sion of a registered investment company identifies signifi-  
18 cant deficiencies in the operations of such company, or of  
19 its investment adviser or principal underwriter, the com-  
20 pany shall provide such report to the directors of such  
21 company.”.

1 **SEC. 108. EXEMPTION FROM IN PERSON MEETING RE-**  
2 **QUIREMENTS.**

3 Section 15(c) of the of the Investment Company Act  
4 of 1940 (15 U.S.C. 80a–15(c)) is amended by adding at  
5 the end the following new sentence: “The Commission, by  
6 rule, regulation, or order, may exempt a registered invest-  
7 ment company subject to this subsection from the require-  
8 ment that the votes of its directors be cast at a meeting  
9 in person when such a requirement is impracticable, sub-  
10 ject to such conditions as the Commission may require.”.

11 **SEC. 109. PROXY VOTING DISCLOSURE.**

12 Section 30 of the Investment Company Act of 1940  
13 (15 U.S.C. 80a–29) is amended by adding at the end the  
14 following new subsection:

15 “(k) PROXY VOTING DISCLOSURE.—Every registered  
16 management investment company, other than a small  
17 business investment company, shall file with the Commis-  
18 sion not later than August 31 of each year an annual re-  
19 port, on a form prescribed by the Commission by rule, con-  
20 taining the registrant’s proxy voting record for the most  
21 recent twelve-month period ending on June 30. The finan-  
22 cial statements of every such company shall state that in-  
23 formation regarding how the company voted proxies relat-  
24 ing to portfolio securities during the most recent 12-month  
25 period ending on June 30 is available—

1           “(1) without charge, upon request, by calling a  
2           specified toll-free (or collect) telephone number; or  
3           on or through the company’s website at a specified  
4           Internet address; or both; and  
5           “(2) on the Commission’s website.”.

6 **SEC. 110. INCENTIVE COMPENSATION AND MUTUAL FUND**  
7 **SALES.**

8           (a) **COMMISSION RULE REQUIRED.**—Within 270  
9           days after the date of enactment of this Act, the Commis-  
10          sion shall by rule prohibit, as a means reasonably designed  
11          to prevent fraudulent, deceptive, or manipulative acts and  
12          practices, the sale of the securities of an investment com-  
13          pany or of municipal fund securities by a broker or dealer  
14          or by a municipal securities broker or dealer without the  
15          disclosure of—

16               (1) the amount and source of sales fees, pay-  
17               ments by persons other than the investment com-  
18               pany that are intended to facilitate the sale and dis-  
19               tribution of the securities, and commissions for ef-  
20               fecting portfolio securities transactions, or other  
21               payments, paid to such broker or dealer, or munic-  
22               ipal securities broker or dealer, or associated person  
23               thereof in connection with such sale;

1           (2) any commission or other fees or charges the  
2 investor has paid or will or might be subject to, in-  
3 cluding as a result of purchases or redemptions;

4           (3) any conflicts of interest that any associated  
5 person of the investor's broker or dealer or munic-  
6 ipal securities broker or dealer may face due to the  
7 receipt of differential compensation in connection  
8 with such sale; and

9           (4) information about the estimated amount of  
10 any asset-based distribution expenses incurred, or to  
11 be incurred, by the investment company in connec-  
12 tion with the investor's purchase of the securities.

13       (b) BENCHMARKS.—In connection with the rule re-  
14 quired by subsection (a), the Commission shall, to the ex-  
15 tent practical, establish standards for such disclosures.

16       (c) DEFINITIONS.—

17           (1) DIFFERENTIAL COMPENSATION.—For pur-  
18 poses of this section, an associated person of a  
19 broker or dealer shall be considered to receive dif-  
20 ferential compensation if such person receives any  
21 increased or additional remuneration, in whatever  
22 form—

23           (A) for sales of the securities of an invest-  
24 ment company or municipal fund security that  
25 is affiliated with, or otherwise specifically des-

1           ignated by, such broker or dealer or municipal  
2           securities broker or dealer, as compared with  
3           the remuneration for sales of securities of an  
4           investment company or municipal fund security  
5           offered by such broker or dealer or municipal  
6           securities broker or dealer that are not so affili-  
7           ated or designated; or

8           (B) for the sale of any class of securities  
9           of an investment company or municipal fund se-  
10          curity as compared with the remuneration for  
11          the sale of a class of securities of such invest-  
12          ment company or municipal fund security (of-  
13          fered by such broker or dealer or municipal se-  
14          curities broker or dealer) that charges a sales  
15          load (as defined in section 2(a)(35) of the In-  
16          vestment Company Act of 1940 (15 U.S.C.  
17          80a-2(a)(35)) only at the time of such a sale.

18          (2) MUNICIPAL FUND SECURITY.—For pur-  
19          poses of this section, a municipal fund security is  
20          any municipal security issued by an issuer that, but  
21          for the application of section 2(b) of the Investment  
22          Company Act of 1940 (15 U.S.C. 80a-2(b)), would  
23          constitute an investment company within the mean-  
24          ing of section 3 of the Investment Company Act of  
25          1940 (15 U.S.C. 80a-3).



1 **SEC. 111. COMMISSION STUDY AND REPORT REGULATING**  
2 **SOFT DOLLAR ARRANGEMENTS.**

3 (a) STUDY REQUIRED.—

4 (1) IN GENERAL.—The Commission shall con-  
5 duct a study of the use of soft dollar arrangements  
6 by investment advisers as contemplated by section  
7 28(e) of the Securities Exchange Act of 1934 (15  
8 U.S.C. 78bb(e)).

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

11 (A) the trends in the average amounts of  
12 soft dollar commissions paid by investment ad-  
13 visers and investment companies in the past 3  
14 years;

15 (B) the types of services provided through  
16 soft dollar arrangements;

17 (C) the benefits and disadvantages of the  
18 use of soft dollars for investors, including the  
19 extent to which use of soft dollar arrangements  
20 affects the ability of mutual fund investors to  
21 evaluate and compare the expenses of different  
22 mutual funds;

23 (D) the potential or actual conflicts of in-  
24 terest (or both potential and actual conflicts)  
25 created by soft dollar arrangements, including  
26 whether certain potential conflicts are being

1 managed effectively by other laws and regula-  
2 tions specifically addressing those situations,  
3 the role of the board of directors in managing  
4 these potential or actual (or both) conflicts, and  
5 the effectiveness of the board in this capacity;

6 (E) the transparency of such soft dollar  
7 arrangements to investment company share-  
8 holders and investment advisory clients of in-  
9 vestment advisers, the extent to which enhanced  
10 disclosure is necessary or appropriate to enable  
11 investors to better understand the impact of  
12 these arrangements, and an assessment of  
13 whether the cost of any enhanced disclosure or  
14 other regulatory change would result in benefits  
15 to the investor; and

16 (F) whether such section 28(e) should be  
17 modified, and whether other regulatory or legis-  
18 lative changes should be considered and adopted  
19 to benefit investors.

20 (b) REPORT REQUIRED.—The Commission shall sub-  
21 mit a report on the study required by subsection (a) to  
22 the Committee on Financial Services of the House of Rep-  
23 resentatives and the Committee on Banking, Housing, and  
24 Urban Affairs of the Senate, no later than one year after  
25 the date of enactment of this Act.

1 **SEC. 112. STUDY OF ARBITRATION CLAIMS.**

2 (a) STUDY REQUIRED.—The Securities and Ex-  
3 change Commission shall conduct a study of the increased  
4 rate of arbitration claims and decisions involving mutual  
5 funds since 1995 for the purposes of identifying trends  
6 in arbitration claim rates and, if applicable, the causes of  
7 such increased rates and the means to avert such causes.

8 (b) REPORT.—The Securities and Exchange Commis-  
9 sion shall submit a report on the study required by sub-  
10 section (a) to the Committee on Financial Services of the  
11 House of Representatives and the Committee on Banking,  
12 Housing, and Urban Affairs of the Senate not later than  
13 one year after the date of enactment of this Act.

14 **TITLE II—PREVENTION OF ABU-**  
15 **SIVE MUTUAL FUND PRAC-**  
16 **TICES**

17 **SEC. 201. PREVENTION OF FRAUD; INTERNAL COMPLIANCE**  
18 **AND CONTROL PROCEDURES.**

19 (a) AMENDMENT.—Subsection (j) of section 17 of the  
20 Investment Company Act of 1940 (15 U.S.C. 80a–17(j))  
21 is amended to read as follows:

22 “(j) DETECTION AND PREVENTION OF FRAUD.—

23 “(1) COMMISSION RULES TO PROHIBIT FRAUD,  
24 DECEPTION, AND MANIPULATION.—It shall be un-  
25 lawful for any affiliated person of or principal under-  
26 writer for a registered investment company or any

1       affiliated person of an investment adviser of or prin-  
2       cipal underwriter for a registered investment com-  
3       pany, to engage in any act, practice, or course of  
4       business in connection with the purchase or sale, di-  
5       rectly or indirectly, by such person of any security  
6       held or to be acquired by such registered investment  
7       company, or any security issued by such registered  
8       investment company or by an affiliated registered in-  
9       vestment company, in contravention of such rules  
10      and regulations as the Commission may adopt to de-  
11      fine, and prescribe means reasonably necessary to  
12      prevent, such acts, practices, or courses of business  
13      as are fraudulent, deceptive or manipulative.

14           “(2) CODES OF ETHICS.—Such rules and regu-  
15      lations shall include requirements for the adoption of  
16      codes of ethics by registered investment companies  
17      and investment advisers of, and principal under-  
18      writers for, such investment companies establishing  
19      such standards as are reasonably necessary to pre-  
20      vent such acts, practices, or courses of business.  
21      Such rules and regulations shall require each such  
22      registered investment company to disclose such  
23      codes of ethics (and any changes therein) in the  
24      periodic report to shareholders of such company, and  
25      to disclose such code of ethics and any waivers and

1 material violations thereof on a readily accessible  
2 electronic public information facility of such com-  
3 pany and in such additional form and manner as the  
4 Commission shall require by rule or regulation.

5 “(3) ADDITIONAL COMPLIANCE PROCEDURES.—

6 Such rules and regulations shall—

7 “(A) require each investment company and  
8 investment adviser registered with the Commis-  
9 sion to adopt and implement policies and proce-  
10 dures reasonably designed to prevent violation  
11 of the Securities Act of 1933 (15 U.S.C. 78a et  
12 seq.), the Securities Exchange Act of 1934 (15  
13 U.S.C. 78a et seq.), the Sarbanes-Oxley Act of  
14 2002 (15 U.S.C. 7201 et seq.), the Trust In-  
15 denture Act of 1939 (15 U.S.C. 77aaa et seq.),  
16 the Investment Company Act of 1940 (15  
17 U.S.C. 80a–1 et seq.), the Investment Advisers  
18 Act of 1940 (15 U.S.C. 80b et seq.), the Secu-  
19 rities Investor Protection Act of 1970 (15  
20 U.S.C. 78aaa et seq.), subchapter II of chapter  
21 53 of title 31, United States Code, chapter 2 of  
22 title I of Public Law 91–508 (12 U.S.C. 1951  
23 et seq.), or section 21 of the Federal Deposit  
24 Insurance Act (12 U.S.C. 1829b);

1           “(B) require each such company and ad-  
2           viser to review such policies and procedures an-  
3           nually for their adequacy and the effectiveness  
4           of their implementation;

5           “(C) require each such company to appoint  
6           a chief compliance officer to be responsible for  
7           overseeing such policies and procedures—

8                   “(i) whose compensation shall be ap-  
9                   proved by the members of the board of di-  
10                  rectors of the company who are not inter-  
11                  ested persons of such company;

12                  “(ii) who shall report directly to the  
13                  members of the board of directors of the  
14                  company who are not interested persons of  
15                  such company, privately as such members  
16                  request, but no less frequently than annu-  
17                  ally; and

18                  “(iii) whose report to such members  
19                  shall include any violations or waivers of,  
20                  and any other significant issues arising  
21                  under, such policies and procedures; and

22           “(D) require each such company to estab-  
23           lish policies and procedures reasonably designed  
24           to protect any officer, director, employee, con-  
25           tractor, subcontractor, or agent of such com-

pany from retaliation, including discharge, demotion, suspension, harassment, or any other manner of discrimination in the terms and conditions of employment, because of any lawful act done by such officer, director, employee, contractor, subcontractor, or agent to provide information, cause information to be provided, or otherwise assist in an investigation that relates to any conduct which such officer, director, employee, contractor, subcontractor, or agent reasonably believes constitutes a violation of the securities laws or the code of ethics of such investment company.

“(4) SELF-CERTIFICATION.—Such rules and regulations shall require the members of the board of directors who are not interested persons of each registered open-end investment company to certify, in the periodic report to shareholders, or other appropriate disclosure document, that—

“(A) procedures are in place for verifying that the determination of current net asset value of any redeemable security issued by the company used in computing periodically the current price for the purpose of purchase, redemption, and sale complies with the require-

1           ments of the Investment Company Act of 1940  
2           and the rules and regulations thereunder, and  
3           the company is in compliance with such proce-  
4           dures;

5           “(B) procedures are in place for the over-  
6           sight of the flow of funds into and out of the  
7           securities of the company, and the company is  
8           in compliance with such procedures;

9           “(C) procedures are in place to ensure that  
10          investors are receiving any applicable discounts  
11          on front-end sales loads that are disclosed in  
12          the company’s prospectus;

13          “(D) procedures are in place to ensure  
14          that, if the company’s shares are offered as dif-  
15          ferent classes of shares, such classes are de-  
16          signed in the interests of investors, and could  
17          reasonably be an appropriate investment option  
18          for an investor;

19          “(E) procedures are in place to ensure that  
20          information about the company’s portfolio secu-  
21          rities is not disclosed in violation of the securi-  
22          ties laws or the company’s code of ethics;

23          “(F) the members of the board of directors  
24          who are not interested persons of the company  
25          have reviewed and approved the compensation



1 of the company’s portfolio manager in connec-  
 2 tion with their consideration of the investment  
 3 advisory contract under section 15(c);

4 “(G) the company has established and en-  
 5 forces a code of ethics as required by paragraph  
 6 (2) of this subsection; and

7 “(H) the company is in compliance with  
 8 the additional requirements of paragraph (3) of  
 9 this subsection.”.

10 (b) DEADLINE FOR RULES.—The Securities and Ex-  
 11 change Commission shall prescribe rules to implement the  
 12 amendment made by subsection (a) of this section within  
 13 90 days after the date of enactment of this Act.

14 **SEC. 202. BAN ON JOINT MANAGEMENT OF MUTUAL FUNDS**  
 15 **AND HEDGE FUNDS.**

16 (a) AMENDMENT.—Section 15 of the Investment  
 17 Company Act of 1940 (15 U.S.C. 80a-15) is further  
 18 amended by adding at the end the following new sub-  
 19 section:

20 “(h) BAN ON JOINT MANAGEMENT OF MUTUAL  
 21 FUNDS AND HEDGE FUNDS.—

22 “(1) PROHIBITION OF JOINT MANAGEMENT.—It  
 23 shall be unlawful for any individual to serve or act  
 24 as the portfolio manager or investment adviser of a  
 25 registered open-end investment company if such in-

1       dividual also serves or acts as the portfolio manager  
2       or investment adviser of an investment company  
3       that is not registered or of such other categories of  
4       companies as the Commission shall prescribe by rule  
5       in order to prohibit conflicts of interest, such as con-  
6       flicts in the selection of the portfolio securities.

7               “(2)   EXCEPTIONS.—Notwithstanding para-  
8       graph (1), the Commission may, by rule, regulation,  
9       or order, permit joint management by a portfolio  
10      manager in exceptional circumstances when nec-  
11      essary to protect the interest of investors, provided  
12      that such rule, regulation, or order requires—

13               “(A) enhanced disclosure by the registered  
14      open-end investment company to investors of  
15      any conflicts of interest raised by such joint  
16      management; and

17               “(B) fair and equitable policies and proce-  
18      dures for the allocation of securities to the port-  
19      folios of the jointly managed companies, and  
20      certification by the members of the board of di-  
21      rectors who are not interested persons of such  
22      registered open-end investment company, in the  
23      periodic report to shareholders, or other appro-  
24      priate disclosure document, that such policies

1 and procedures of such company are fair and  
2 equitable.

3 “(3) DEFINITION.—For purposes of this sub-  
4 section, the term ‘portfolio manager’ means the indi-  
5 vidual or individuals who are designated as respon-  
6 sible for decision-making in connection with the se-  
7 curities purchased and sold on behalf of a registered  
8 open-end investment company, but shall not include  
9 individuals who participate only in making research  
10 recommendations or executing transactions on behalf  
11 of such company.”.

12 (b) DEADLINE FOR RULES.—The Securities and Ex-  
13 change Commission shall prescribe rules to implement the  
14 amendment made by subsection (a) of this section within  
15 90 days after the date of enactment of this Act.

16 **SEC. 203. SHORT TERM TRADING BY INTERESTED PERSONS**  
17 **PROHIBITED.**

18 (a) SHORT TERM TRADING PROHIBITED.—Section  
19 17 of the Investment Company Act of 1940 (15 U.S.C.  
20 80a–17) is further amended by adding at the end the fol-  
21 lowing new subsection:

22 “(k) SHORT TERM TRADING PROHIBITED.—It shall  
23 be unlawful for any officer, director, partner, or employee  
24 of a registered investment company, any affiliated person,  
25 investment adviser, or principal underwriter of such com-

1 pany, or any officer, director, partner, or employee of such  
2 an affiliated person, investment adviser, or principal un-  
3 derwriter, to engage in short-term transactions, as such  
4 term is defined by the Commission by rule, in any securi-  
5 ties of which such company, or any affiliate of such com-  
6 pany, is the issuer, except that this subsection shall not  
7 prohibit transactions in money market funds, other funds  
8 the investment policy of which expressly permits short-  
9 term transactions, or such other categories of registered  
10 investment companies as the Commission shall specify by  
11 rule.”.

12 (b) INCREASED REDEMPTION FEES PERMITTED FOR  
13 SHORT TERM TRADING.—Within 90 days after the date  
14 of enactment of this Act, the Securities and Exchange  
15 Commission shall revise rule 11a–3 of its rules under the  
16 Investment Company Act of 1940 (17 CFR 270.11a–30),  
17 or other rules of the Commission, as necessary to permit  
18 an investment company to charge redemption fees in ex-  
19 cess of 2 percent upon the redemption of any securities  
20 of such company that are redeemed within such period  
21 after their purchase as the Commission specifies in such  
22 rule to prevent short term trading that is unfair to the  
23 shareholders of such company.

24 (c) DEADLINE FOR RULES.—The Securities and Ex-  
25 change Commission shall prescribe rules to implement the

1 amendment made by subsection (a) of this section within  
2 90 days after the date of enactment of this Act.

3 **SEC. 204. ELIMINATION OF STALE PRICES.**

4       Within 90 days after the date of enactment of this  
5 Act, the Securities and Exchange Commission shall pre-  
6 scribe, by rule or regulation, standards concerning the ob-  
7 ligation of registered open-end investment companies  
8 under the Investment Company Act of 1940 to apply and  
9 use fair value methods of determination of net asset value  
10 when market quotations are unavailable or do not accu-  
11 rately reflect the fair market value of the companies' port-  
12 folio securities, in order to prevent dilution of the interests  
13 of long-term investors or as necessary in the other inter-  
14 ests of investors. Such rule or regulation shall identify,  
15 in addition to significant events, the conditions or cir-  
16 cumstances from which such obligation will arise, such as  
17 the need to value securities traded on foreign exchanges,  
18 and the methods by which fair value methods shall be ap-  
19 plied in such events, conditions, and circumstances.

20 **SEC. 205. PREVENTION OF UNFAIR AFTER-HOURS TRADING.**

21       (a) **ADDITIONAL RULES REQUIRED.**—Within 90 days  
22 after the date of enactment of this Act, the Securities and  
23 Exchange Commission shall issue rules to prevent trans-  
24 actions in the securities of any registered open-end invest-  
25 ment company in violation of section 22 of the Investment

1 Company Act of 1940 (15 U.S.C. 80a–22), including  
2 after-hours trades that are executed at a price based on  
3 a net asset value that was determined as of a time prior  
4 to the actual execution of the transaction.

5 (b) TRADES COLLECTED BY INTERMEDIARIES.—  
6 Such rules shall permit execution of such after-hours  
7 trades that are provided to the registered open-end invest-  
8 ment company by a broker-dealer, retirement plan admin-  
9 istrator, or other intermediary, after the time as of which  
10 such net asset value was determined, if such trades are  
11 collected by such intermediaries subject to procedures that  
12 are—

13 (1) designed to prevent the acceptance of trades  
14 by such intermediaries after the time as of which net  
15 asset value was determined; and

16 (2) subject to an independent annual audit to  
17 verify that the procedures do not permit the accept-  
18 ance of trades after the time as of which such net  
19 asset value was determined.

20 (c) INDEPENDENTLY MAINTAINED SYSTEMS.—Such  
21 rules shall permit firms that utilize computer systems and  
22 procedures provided by unaffiliated entities to collect  
23 transactions to satisfy the independent audit requirements  
24 under subsection (b)(2) by means of an independent audit  
25 obtained by such unaffiliated entity.

1 **SEC. 206. REPORT ON ADEQUACY OF REMEDIAL ACTIONS.**

2 (a) REPORT REQUIRED.—Within 180 days of enact-  
3 ment, the Securities and Exchange Commission shall sub-  
4 mit a report to the Committee on Financial Services of  
5 the House of Representatives and the Committee on  
6 Banking, Housing, and Urban Affairs of the Senate on  
7 market timing and late trading of mutual funds.

8 (b) REQUIRED CONTENTS OF REPORT.—The report  
9 required by this section shall include the following:

10 (1) The economic harm of market timing and  
11 late trading of mutual fund shares on long-term mu-  
12 tual fund shareholders.

13 (2) The findings by the Commission's Office of  
14 Compliance, Inspections and Examinations, and the  
15 actions taken by the Commission's Division of En-  
16 forcement, regarding—

17 (A) illegal late trading practices;

18 (B) illegal market timing practices; and

19 (C) market timing practices that are not in  
20 violation of prospectus disclosures.

21 (3) When the Commission became aware that  
22 the use of market timing practices was harming  
23 long-term shareholders, and the circumstances sur-  
24 rounding the Commission's discovery of that activity.

1           (4) The steps the Commission has taken since  
2           becoming aware of market timing practices to pro-  
3           tect long-term mutual fund investors.

4           (5) Any additional legislative or regulatory ac-  
5           tion that is necessary to protect long-term mutual  
6           fund shareholders against the detrimental effects of  
7           late trading and market timing practices.

Passed the House of Representatives November 19,  
2003.

Attest:

JEFF TRANDAHL,

*Clerk.*