

108TH CONGRESS
1ST SESSION

S. 1822

To require disclosure of financial relationships between brokers and mutual fund companies and of certain brokerage commissions paid by mutual fund companies.

IN THE SENATE OF THE UNITED STATES

NOVEMBER 5, 2003

Mr. AKAKA (for himself, Mr. FITZGERALD, and Mr. LIEBERMAN) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

A BILL

To require disclosure of financial relationships between brokers and mutual fund companies and of certain brokerage commissions paid by mutual fund companies.

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

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the “Mutual Fund Trans-
5 parency Act of 2003”.

1 **SEC. 2. DISCLOSURE OF FINANCIAL RELATIONSHIPS BE-**
2 **TWEEN BROKERS AND MUTUAL FUND COM-**
3 **PANIES.**

4 (a) IN GENERAL.—Section 15(b) of the Securities
5 Exchange Act of 1934 (15 U.S.C. 78o(b)) is amended by
6 adding at the end the following:

7 “(11) CONFIRMATION OF TRANSACTIONS FOR
8 MUTUAL FUNDS.—

9 “(A) IN GENERAL.—Each broker shall dis-
10 close in writing to customers that purchase the
11 shares of an open-end company registered
12 under section 8 of the Investment Company Act
13 of 1940 (15 U.S.C. 80a–8)—

14 “(i) the amount of any compensation
15 received or to be received by the broker in
16 connection with such transaction from any
17 sources; and

18 “(ii) such other information as the
19 Commission determines appropriate.

20 “(B) TIMING OF DISCLOSURE.—The dis-
21 closure required under subparagraph (A) shall
22 be made to a customer not later than as of the
23 date of the completion of the transaction.

24 “(C) LIMITATION.—The disclosures re-
25 quired under subparagraph (A) may not be
26 made exclusively in—

1 “(i) a registration statement or pro-
 2 spectus of an open-end company; or

3 “(ii) any other filing of an open-end
 4 company with the Commission.

5 “(D) COMMISSION AUTHORITY.—

6 “(i) IN GENERAL.—The Commission
 7 shall promulgate such rules as are nec-
 8 essary to carry out this paragraph not
 9 later than 1 year after the date of enact-
 10 ment of the Mutual Fund Transparency
 11 Act of 2003.

12 “(ii) FORM OF DISCLOSURE.—Disclo-
 13 sures under this paragraph shall be in
 14 such form as the Commission, by rule,
 15 shall require.

16 “(E) DEFINITION.—In this paragraph, the
 17 term ‘open-end company’ has the same meaning
 18 as in section 5 of the Investment Company Act
 19 of 1940 (15 U.S.C. 80a–5).”.

20 (b) DISCLOSURE OF BROKERAGE COMMISSIONS.—
 21 Section 30 of the Investment Company Act of 1940 (15
 22 U.S.C. 80a–29) is amended by adding at the end the fol-
 23 lowing:

24 “(k) DISCLOSURE OF BROKERAGE COMMISSIONS.—
 25 The Commission, by rule, shall require that brokerage

1 commissions as an aggregate dollar amount and percent-
 2 age of assets paid by an open-end company be included
 3 in any disclosure of the amount of fees and expenses that
 4 may be payable by the holder of the securities of such com-
 5 pany for purposes of—

6 “(1) the registration statement of that open-end
 7 company; and

8 “(2) any other filing of that open-end company
 9 with the Commission, including the calculation of ex-
 10 pense ratios.”.

11 **SEC. 3. MUTUAL FUND GOVERNANCE.**

12 (a) INDEPENDENT FUND BOARDS.—Section 10(a) of
 13 the Investment Company Act of 1940 (15 U.S.C. 80a–
 14 10(a)) is amended—

15 (1) by striking “shall have” and inserting the
 16 following: “shall—

17 “(1) have”;

18 (2) by striking “60 per centum” and inserting
 19 “25 percent”;

20 (3) by striking the period at the end and insert-
 21 ing a semicolon; and

22 (4) by adding at the end the following:

23 “(2) have as chairman of its board of directors
 24 an interested person of such registered company; or

1 “(3) have as a member of its board of directors
2 any person that is an interested person of such reg-
3 istered investment company—

4 “(A) who has served without being ap-
5 proved or elected by the shareholders of such
6 registered investment company at least once
7 every 5 years; and

8 “(B) unless such director has been found,
9 on an annual basis, by a majority of the direc-
10 tors who are not interested persons, after rea-
11 sonable inquiry by such directors, not to have
12 any material business or familial relationship
13 with the registered investment company, a sig-
14 nificant service provider to the company, or any
15 entity controlling, controlled by, or under com-
16 mon control with such service provider, that is
17 likely to impair the independence of the direc-
18 tor.”.

19 (b) ACTION BY INDEPENDENT DIRECTORS.—Section
20 10 of the Investment Company Act of 1940 (15 U.S.C.
21 80a–10) is amended by adding at the end the following:

22 “(i) ACTION BY BOARD OF DIRECTORS.—No action
23 taken by the board of directors of a registered investment
24 company may require the vote of a director who is an in-
25 terested person of such registered investment company.

1 “(j) INDEPENDENT COMMITTEE.—

2 “(1) IN GENERAL.—The members of the board
3 of directors of a registered investment company who
4 are not interested persons of such registered invest-
5 ment company shall establish a committee comprised
6 solely of such members, which committee shall be re-
7 sponsible for—

8 “(A) selecting persons to be nominated for
9 election to the board of directors; and

10 “(B) adopting qualification standards for
11 the nomination of directors.

12 “(2) DISCLOSURE.—The standards developed
13 under paragraph (1)(B) shall be disclosed in the reg-
14 istration statement of the registered investment com-
15 pany.”.

16 (c) DEFINITION OF INTERESTED PERSON.—Section
17 2(a)(19) of the Investment Company Act of 1940 (15
18 U.S.C. 80a–2) is amended—

19 (1) in subparagraph (A)—

20 (A) in clause (iv), by striking “two” and
21 inserting “5”; and

22 (B) by striking clause (vii) and inserting
23 the following:

24 “(vii) any natural person who has
25 served as an officer or director, or as an

1 employee within the preceding 10 fiscal
2 years, of an investment adviser or principal
3 underwriter to such registered investment
4 company, or of any entity controlling, con-
5 trolled by, or under common control with
6 such investment adviser or principal under-
7 writer;

8 “(viii) any natural person who has
9 served as an officer or director, or as an
10 employee within the preceding 10 fiscal
11 years, of any entity that has within the
12 preceding 5 fiscal years acted as a signifi-
13 cant service provider to such registered in-
14 vestment company, or of any entity con-
15 trolling, controlled by, or under the com-
16 mon control with such service provider;

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

22 “(I) a material business relation-
23 ship with the investment company or
24 an affiliated person of such invest-
25 ment company;

1 “(II) a close familial relationship
 2 with any natural person who is an af-
 3 filiated person of such investment
 4 company; or

5 “(III) any other reason deter-
 6 mined by the Commission.”;

7 (2) in subparagraph (B)—

8 (A) in clause (iv), by striking “two” and
 9 inserting “5”; and

10 (B) by striking clause (vii) and inserting
 11 the following:

12 “(vii) any natural person who is a
 13 member of a class of persons that the
 14 Commission, by rule or regulation, deter-
 15 mines is unlikely to exercise an appropriate
 16 degree of independence as a result of—

17 “(I) a material business relation-
 18 ship with such investment adviser or
 19 principal underwriter or affiliated per-
 20 son of such investment adviser or
 21 principal underwriter;

22 “(II) a close familial relationship
 23 with any natural person who is an af-
 24 filiated person of such investment ad-
 25 viser or principal underwriter; or

1 “(III) any other reason as deter-
 2 mined by the Commission.”.

3 (d) DEFINITION OF SIGNIFICANT SERVICE PRO-
 4 VIDER.—Section 2(a) of the Investment Company Act of
 5 1940 is amended by adding at the end the following:

6 “(53) SIGNIFICANT SERVICE PROVIDER.—

7 “(A) IN GENERAL.—Not later than 270
 8 days after the date of enactment of the Mutual
 9 Fund Transparency Act of 2003, the Securities
 10 and Exchange Commission shall issue final
 11 rules defining the term ‘significant service pro-
 12 vider’.

13 “(B) REQUIREMENTS.—The definition de-
 14 veloped under paragraph (1) shall include, at a
 15 minimum, the investment adviser and principal
 16 underwriter of a registered investment company
 17 for purposes of paragraph (19).”.

18 (e) STUDY.—

19 (1) IN GENERAL.—The Securities and Ex-
 20 change Commission shall conduct a study to deter-
 21 mine whether the best interests of investors in mu-
 22 tual funds would be served by the creation of a Mu-
 23 tual Fund Oversight Board that—

1 (A) has inspection, examination, and en-
 2 forcement authority over mutual fund boards of
 3 directors;

4 (B) is funded by assessments against mu-
 5 tual fund assets;

6 (C) the members of which are selected by
 7 the Securities and Exchange Commission; and

8 (D) has rulemaking authority.

9 (2) REPORT.—Not later than 1 year after the
 10 date of enactment of this Act, the Securities and Ex-
 11 change Commission shall submit a report on the
 12 study required under paragraph (1) to—

13 (A) the Committee on Banking, Housing,
 14 and Urban Affairs of the Senate; and

15 (B) the Committee on Financial Services
 16 of the House of Representatives.

17 **SEC. 4. PORTFOLIO MANAGER COMPENSATION.**

18 Not later than 270 days after the date of enactment
 19 of this Act, the Securities and Exchange Commission shall
 20 prescribe rules under the Investment Company Act of
 21 1940, requiring that a registered investment company dis-
 22 close the structure of, or method used to determine, the
 23 compensation of—

1 (1) individuals employed by the investment ad-
2 viser of the company to manage the portfolio of the
3 company; and

4 (2) the ownership interest of such individuals in
5 the securities of the registered investment company.

6 **SEC. 5. FINANCIAL LITERACY AMONG MUTUAL FUND IN-**
7 **VESTORS STUDY.**

8 (a) IN GENERAL.—The Securities and Exchange
9 Commission shall conduct a study to identify—

10 (1) the existing level of financial literacy among
11 investors that purchase shares of open-end compa-
12 nies, as such term is defined under section 5 of the
13 Investment Company Act of 1940, that are reg-
14 istered under section 8 of such Act;

15 (2) the most useful and understandable relevant
16 information that investors need to make sound fi-
17 nancial decisions prior to purchasing such shares;

18 (3) methods to increase the transparency of ex-
19 penses and potential conflicts of interest in trans-
20 actions involving the shares of open-end companies;

21 (4) the existing private and public efforts to
22 educate investors; and

23 (5) a strategy to increase the financial literacy
24 of investors that results in a positive change in in-
25 vestor behavior.

1 (b) REPORT.—Not later than 1 year after the date
2 of enactment of this Act, the Securities and Exchange
3 Commission shall submit a report on the study required
4 under subsection (a) to—

5 (1) the Committee on Banking, Housing, and
6 Urban Affairs of the Senate; and

7 (2) the Committee on Financial Services of the
8 House of Representatives.

9 **SEC. 6. STUDY REGARDING MUTUAL FUND ADVERTISING.**

10 (a) IN GENERAL.—The Comptroller General of the
11 United States shall conduct a study on mutual fund adver-
12 tising to identify—

13 (1) existing and proposed regulatory require-
14 ments for open-end investment company advertise-
15 ments;

16 (2) current marketing practices for the sale of
17 open-end investment company shares, including the
18 use of unsustainable past performance data, funds
19 that have merged, and incubator funds;

20 (3) the impact of such advertising on con-
21 sumers;

22 (4) recommendations to improve investor pro-
23 tections in mutual fund advertising and additional
24 information necessary to ensure that investors can

1 make informed financial decisions when purchasing
2 shares.

3 (b) REPORT.—Not later than 1 year after the date
4 of enactment of this Act, the Comptroller General of the
5 United States shall submit a report on the results of the
6 study conducted under subsection (a) to—

7 (1) the Committee on Banking, Housing, and
8 Urban Affairs of the United States Senate; and

9 (2) the Committee on Financial Services of the
10 House of Representatives.

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