

108TH CONGRESS  
1ST SESSION

# S. 1958

To prevent the practice of late trading by mutual funds, and for other purposes.

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IN THE SENATE OF THE UNITED STATES

NOVEMBER 25, 2003

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

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## A BILL

To prevent the practice of late trading by mutual funds,  
and for other purposes.

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

3 **SEC. 1. SHORT TITLE; TABLE OF CONTENTS.**

4 (a) SHORT TITLE.—This Act may be cited as the  
5 “Mutual Fund Investor Protection Act of 2003”.

6 (b) TABLE OF CONTENTS.—The table of contents for  
7 this Act is as follows:

Sec. 1. Short title; table of contents.

Sec. 2. Definitions.

### TITLE I—REGULATORY IMPROVEMENTS.

Sec. 101. Regulatory improvements.

## TITLE II—MUTUAL FUND OVERSIGHT BOARD.

- Sec. 201. Establishment; administrative provisions.
- Sec. 202. Registration with the board.
- Sec. 203. Auditing, quality control, and independence standards and rules.
- Sec. 204. Inspections of registered mutual funds.
- Sec. 205. Investigations and disciplinary proceedings.
- Sec. 206. Commission oversight of the board.
- Sec. 207. Funding.
- Sec. 208. No preemption of State securities actions.
- Sec. 209. Arbitration of investor claims in independent forum.

1 **SEC. 2. DEFINITIONS.**

2 In this Act, the following definitions shall apply:

3 (1) BOARD.—The term “Board” means the  
 4 Mutual Fund Oversight Board established under  
 5 section 201.

6 (2) COMMISSION.—The term “Commission  
 7 means the Security and Exchange Commission.

8 (3) MUTUAL FUND.—The term “mutual fund”  
 9 means such entities designated as mutual funds by  
 10 regulation of the Mutual Fund Oversight Board es-  
 11 tablished under title II of this Act.

12 (4) REGISTERED MUTUAL FUND.—The term  
 13 “registered mutual fund” has the same meaning as  
 14 in section 5 of the Investment Company Act of  
 15 1940.

16 (5) SECURITIES LAWS.—The term “securities  
 17 laws” has the same meaning as in section 3 of the  
 18 Securities Exchange Act of 1934.

# TITLE I—REGULATORY IMPROVEMENTS

## SEC. 101. REGULATORY IMPROVEMENTS.

(a) PRICING OF SHARES.—The Investment Company Act of 1940 (15 U.S.C. 80a–1 et seq.) is amended by inserting after section 11 the following:

### “SEC. 11A. PRICING OF SECURITIES.

“On any calendar day, the purchaser of the securities of a registered open-end company shall be required to place an order to purchase such securities prior to the time at which the registered open-end company sets the price of the securities for that day in order to purchase the securities at that price.”.

### (b) PENALTIES.—

(1) SECURITIES ACT OF 1933.—Section 24 of the Securities Act of 1933 (15 U.S.C. 77x) is amended—

(A) by striking “Any person” and inserting the following:

“(a) IN GENERAL.—Except as provided under subsection (b), any person”; and

(B) by adding at the end the following:

“(b) OPEN-END COMPANIES.—Any person who willfully violates section 17(a) with respect to the offer or sale of any security of a registered open-end company (as that

1 term is defined under section 5 of the Investment Com-  
 2 pany Act of 1940) shall, upon conviction, be fined not  
 3 more than \$1,000,000, imprisoned for not more than 20  
 4 years, or both.”.

5 (2) SECURITIES EXCHANGE ACT OF 1934.—Sec-  
 6 tion 32(a) of the Securities Exchange Act of 1934  
 7 (15 U.S.C. 78ff(a)) is amended—

8 (A) by striking “(a) Any person” and in-  
 9 serting the following:

10 “(a) WILLFUL VIOLATIONS.—

11 “(1) IN GENERAL.—Except as provided under  
 12 paragraphs (2) and (3), any person”; and

13 (B) by adding at the end the following:

14 “(2) OPEN-END COMPANIES; BROKERAGE  
 15 TRANSACTIONS.—

16 “(A) IN GENERAL.—A person shall, upon  
 17 conviction, be subject to the penalties in sub-  
 18 paragraph (B) if such person willfully vio-  
 19 lates—

20 “(i) section 10(b), with respect to the  
 21 purchase or sale of the securities of a reg-  
 22 istered open-end company (as that term is  
 23 defined under section 5 of the Investment  
 24 Company Act of 1940); or

1 “(ii) section 17(a) of the Securities  
2 Act of 1933.

3 “(B) PENALTIES.—Any person convicted  
4 of a violation described in subparagraph (A)  
5 shall be fined not more than \$10,000,000, im-  
6 prisoned for not more than 25 years, or both,  
7 or, if the person is not a natural person, fined  
8 not more than \$50,000,000.

9 “(3) LIFETIME BAN.—Any natural person who  
10 engages in a violation described in paragraph (2)  
11 shall be prohibited from participating in any sale or  
12 offer to sell securities for the life of such person.”.

13 (3) INVESTMENT COMPANY ACT OF 1940.—Sec-  
14 tion 49 of the Investment Company Act of 1940 (15  
15 U.S.C. 80a–48) is amended—

16 (A) by striking “Any person” and inserting  
17 the following:

18 “(a) IN GENERAL.—Except as provided under sub-  
19 section (b), any person”; and

20 (B) by adding at the end the following:

21 “(b) OPEN-END COMPANIES.—Any person who will-  
22 fully violates section 22(a) with respect to the securities  
23 of a registered open-end company shall, upon conviction,  
24 be fined not more than \$1,000,000, imprisoned not more  
25 than 20 years, or both.”.

1 (c) RICO ENFORCEMENT.—Section 1961(1) of title  
 2 18, United States Code, is amended—

3 (1) in subparagraph (E), by striking “or” at  
 4 the end; and

5 (2) by striking the semicolon at the end and in-  
 6 serting “, (G) any act that violates section 17(a) of  
 7 the Securities Act of 1933, with respect to the sale  
 8 of or an offer to sell securities of a registered open-  
 9 end company (as that term is defined under section  
 10 5 of the Investment Company Act of 1940), (H) sec-  
 11 tion 10(b) or 17(a) of the Securities Exchange Act  
 12 of 1934, with respect to the purchase or sale of the  
 13 securities of such a registered open-end company, or  
 14 (I) section 22(c) of the Investment Company Act of  
 15 1940, with respect to the valuation of the securities  
 16 of such a registered open-end company;”.

17 (d) DISCLOSURE OF MARKET TIMING POLICIES.—  
 18 Section 24 of the Investment Company Act of 1940 (15  
 19 U.S.C. 80a–24) is amended by adding at the end the fol-  
 20 lowing:

21 “(h) MARKET TIMING POLICIES.—Each prospectus  
 22 distributed by a registered open-end company shall dis-  
 23 close—

1 “(1) the policies of the registered open-end  
 2 company with respect to the timing of the pricing of  
 3 its shares; and

4 “(2) the steps taken by the registered open-end  
 5 company to prevent the abuse of such pricing poli-  
 6 cies.”.

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

10 (1) by striking “60 per centum” and inserting  
 11 “one-fourth”; and

12 (2) by adding at the end the following:

13 “(i) CHAIRMAN.—No registered investment company  
 14 have as chairman of such board an interested person of  
 15 such registered company. Such chairman shall have access  
 16 to all information, including but not limited to any outside  
 17 advisory, management, marketing, or investment service  
 18 fees paid by the investment company.”.

19 (f) DEFINITION OF INTERESTED PERSON.—Section  
 20 2(a)(19) of the Investment Company Act of 1940 (15  
 21 U.S.C. 80a–2(a)(19)) is amended—

22 (1) in subparagraph (A)—

23 (A) by striking clauses (v) and (vi) and in-  
 24 serting the following:

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

“(I) a material business or professional relationship with the company or any affiliated person of the company; or

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

(B) by redesignating clause (vii) as clause (vi); and  
(2) in subparagraph (B)—

(A) by striking clauses (v) and (vi) and inserting the following:

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



1 “(I) a material business or pro-  
 2 fessional relationship with such invest-  
 3 ment adviser or principal underwriter  
 4 (or affiliated person thereof); or

5 “(II) a close familial relationship  
 6 with a natural person who is such in-  
 7 vestment adviser or principal under-  
 8 writer (or affiliated person thereof),”;  
 9 and

10 (B) by redesignating clause (v) as clause  
 11 (vi).

12 (g) FIDUCIARY DUTY OF BOARD OF DIRECTORS.—

13 (1) IN GENERAL.—Not later than 270 days  
 14 after enactment of this Act, the Securities and Ex-  
 15 change Commission shall publish regulations to re-  
 16 quire that the board of directors of a registered in-  
 17 vestment company shall have a fiduciary duty—

18 (A) to demonstrate that the negotiated ad-  
 19 visory, management, marketing, and investment  
 20 service fees that are reasonable and are in the  
 21 best interest of their shareholders. This may be  
 22 accomplished by obtaining multiple bids, an  
 23 independent evaluation or appraisal, including a  
 24 provision in all fee contracts preventing con-  
 25 tractors from charging rates in excess of those

1           paid by other clients, and any other means  
 2           practicable to ensure that shareholders are not  
 3           overcharged for any services provided to the  
 4           registered investment company; and

5           (B) to provide a report to the Commission,  
 6           which shall also be disclosed in any prospectus  
 7           delivered to shareholders of the company, on  
 8           any significant or material business or profes-  
 9           sional relationship with any advisory, manage-  
 10          ment, marketing, investment, or other service  
 11          provided to the registered investment company  
 12          to ensure that such services are provided in the  
 13          best interest of their shareholders.

14       (h) IMPROVED TRANSPARENCY OF MUTUAL FUND

15   COSTS.—

16       (1) REGULATION REVISION REQUIRED.—Not  
 17       later than 270 days after the date of enactment of  
 18       this Act, the Securities and Exchange Commission  
 19       shall revise regulation under the Securities Act of  
 20       1933, the Securities Exchange Act of 1934, or the  
 21       Investment Company Act of 1940, or any combina-  
 22       tion thereof, to require, consistent with the protec-  
 23       tion of investors and the public interest, improved  
 24       disclosure with respect to any registered investment  
 25       company, in the quarterly statement or other peri-

1       odic report to shareholders or other appropriate dis-  
2       closure document, of—

3               (A) the estimated amount, in dollars, of  
4       the operating expenses of the company, includ-  
5       ing any advisory, management, marketing, and  
6       investment service fees, that are born by the  
7       shareholders, and the amount born by each  
8       shareholder of the company, based on the in-  
9       vestment of each shareholder in the company;

10              (B) the structure of, or method used to de-  
11       termine, the compensation of individuals em-  
12       ployed by the investment adviser of the com-  
13       pany to manage the portfolio of the company,  
14       and the ownership interest of such individuals  
15       in the securities of the company;

16              (C) the portfolio turnover rate of the com-  
17       pany, set forth in a manner that facilitates  
18       comparison among investment companies, and a  
19       description of the implications of a high turn-  
20       over rate for portfolio transaction costs and  
21       performance;

22              (D) information concerning any payments  
23       of commissions for effecting securities trans-  
24       actions to a member of an exchange, broker, or  
25       dealer who—

1 (i) furnishes advice, either directly or  
2 through publications or writings, as to the  
3 value of securities, the advisability of in-  
4 vesting in, purchasing, or selling securities,  
5 and the availability of securities or pur-  
6 chasers or sellers of securities;

7 (ii) furnishes analyses and reports  
8 concerning issuers, industries, securities,  
9 economic factors and trends, portfolio  
10 strategy, and the performance of accounts;  
11 and

12 (iii) facilitates the sale or distribution  
13 of the shares of the company;

14 (E) information concerning payments by  
15 any person other than the company that are in-  
16 tended to facilitate the sale and distribution of  
17 the shares of the company; and

18 (F) information concerning discounts on  
19 front-end sales loads for which investors may be  
20 eligible including the minimum purchase  
21 amounts required for such discounts.

22 (2) APPROPRIATE DISCLOSURE DOCUMENT.—

23 (A) IN GENERAL.—For the purposes of  
24 paragraph (1), a disclosure shall not be consid-  
25 ered to be made in an appropriate disclosure

document if the disclosure is made exclusively in a prospectus or statement of additional information, or both such documents.

(B) EXCEPTIONS.—Notwithstanding subparagraph (A), the disclosures required by subparagraphs (B) and (D) of paragraph (1) may be considered to be made in an appropriate disclosure document if the disclosure is made exclusively in a prospectus or statement of additional information, or both such documents.

(3) CONCEPT RELEASE REQUIRED.—

(A) IN GENERAL.—The Commission shall issue a concept release examining the issue of portfolio transaction costs incurred by investment companies including commission, spread, opportunity, and market impact costs, with respect to trading of portfolio securities and any advisory, management, marketing, and investment service fees paid by investment companies and how such costs may be disclosed to mutual fund investors in a manner that will enable investors to compare such costs among funds.

(B) REPORT AND RECOMMENDATIONS REQUIRED.—Not later than 270 days after the date of enactment of this Act, the Commission

1 shall submit a report on the findings from the  
2 concept release required under subparagraph  
3 (A), as well as any legislative and regulatory  
4 recommendations, if any, to the Committee on  
5 Banking, Housing, and Urban Affairs of the  
6 Senate and the Committee on Financial Serv-  
7 ices of the House of Representatives.

8 (4) ADDITIONAL REQUIREMENT FOR FEE  
9 STATEMENT.—

10 (A) IN GENERAL.—Not later than 270  
11 days after the date of enactment of this Act,  
12 the Commission shall prescribe a rule to re-  
13 quire, with respect to any registered investment  
14 company, in the quarterly statement or other  
15 periodic report, or other appropriate disclosure  
16 document, a statement informing shareholders  
17 of what amount of fees they have paid on each  
18 \$1,000 of their investments over the past 365  
19 days, that such fees have been deducted from  
20 the amounts shown on the statements, and  
21 where such shareholders may find additional in-  
22 formation regarding the amount of these fees.

23 (B) APPROPRIATE DISCLOSURE DOCU-  
24 MENT.—The statement required by subpara-  
25 graph (A) shall not be considered to be made

1 in an appropriate disclosure document unless  
 2 such statement is—

3 (i) made in each periodic statement to  
 4 a shareholder that discloses the value of  
 5 the holdings of the shareholder in the secu-  
 6 rities of the company; and

7 (ii) prominently displayed, in a loca-  
 8 tion in close proximity to the statement of  
 9 the shares account value.

10 (5) REDUCING BURDENS ON SMALL FUNDS.—

11 In prescribing rules under this subsection, the Com-  
 12 mission shall give consideration to methods for re-  
 13 ducing for small investment companies the burdens  
 14 of making disclosures by requiring such rules, con-  
 15 sistent with the public interest and the protection of  
 16 investors.

17 (i) SHORT-TERM TRADING BY INTERESTED PERSONS  
 18 PROHIBITED.—

19 (1) SHORT-TERM TRADING PROHIBITED.—Sec-  
 20 tion 17 of the Investment Company Act of 1940 (15  
 21 U.S.C. 80a–17) is amended by adding at the end the  
 22 following:

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

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

12 (j) MUTUAL FUND COMPLIANCE OFFICER.—Not  
13 later than 270 days after the date of enactment of this  
14 Act, the Commission shall, by rule, require each registered  
15 investment company to appoint a compliance officer to en-  
16 sure that such company is complying with all relevant  
17 rules and regulations, consistent with the protection of in-  
18 vestors and the public interest. Each compliance officer  
19 of a registered investment company shall report only to  
20 directors that are not interested persons of the company,  
21 as such term is defined in section 2(a)(19) of the Invest-  
22 ment Company Act of 1940 (15 U.S.C. 80a–2(a)(19)).



## **TITLE II—MUTUAL FUND OVERSIGHT BOARD**

### **SEC. 201. ESTABLISHMENT; ADMINISTRATIVE PROVISIONS.**

(a) ESTABLISHMENT OF BOARD.—There is established the Mutual Fund Oversight Board, to oversee the conduct of mutual funds and related matters, in order to protect the interests of investors. The Board shall be a body corporate, operate as a nonprofit corporation, and have succession until dissolved by an Act of Congress.

(b) STATUS.—The Board shall not be an agency or establishment of the United States Government, and, except as otherwise provided in this title, shall be subject to, and have all of the powers conferred upon a nonprofit corporation by the District of Columbia Nonprofit Corporation Act. Each member and person employed by the Board shall be deemed to be an officer or employee of, or agent for, the Federal Government by reason of such service.

(c) DUTIES OF THE BOARD.—The Board shall, subject to action by the Commission under section 206, and once a determination is made by the Commission under subsection (d) of this section—

(1) register mutual funds in accordance with section 202;

1           (2) establish or adopt, or both, by rule, internal  
2           auditing, quality control, ethics, independence, and  
3           other standards relating to the conduct of mutual  
4           funds, in accordance with section 203;

5           (3) conduct inspections of mutual funds, in ac-  
6           cordance with section 204 and the rules of the  
7           Board;

8           (4) conduct investigations and disciplinary pro-  
9           ceedings concerning, and impose appropriate sanc-  
10          tions where justified upon, mutual funds and associ-  
11          ated persons of such mutual funds, in accordance  
12          with section 205;

13          (5) perform such other duties and functions as  
14          the Board determines are necessary or appropriate  
15          to promote high professional standards among, and  
16          improve the quality of services offered by, mutual  
17          funds, in order to protect investors, or to further the  
18          public interest;

19          (6) enforce compliance with this title, the rules  
20          of the Board, professional standards, and the securi-  
21          ties laws relating to mutual funds and associated  
22          persons thereof; and

23          (7) set the budget and manage the operations  
24          of the Board and the staff of the Board.

1       (d) COMMISSION DETERMINATION.—The members of  
2 the Board shall take such action (including hiring of staff,  
3 proposal of rules, and adoption of initial and transitional  
4 auditing and other professional standards) as may be nec-  
5 essary or appropriate to enable the Commission to deter-  
6 mine, not later than 270 days after the date of enactment  
7 of this Act, that the Board is so organized and has the  
8 capacity to carry out the requirements of this title, and  
9 to enforce compliance with this title by registered mutual  
10 funds and associated persons thereof.

11       (e) BOARD MEMBERSHIP.—

12           (1) COMPOSITION.—The Board shall have 5  
13 members, appointed in accordance with paragraph  
14 (3), from among prominent individuals of integrity  
15 and reputation who have a demonstrated commit-  
16 ment to the interests of investors and the public,  
17 and an understanding of the responsibilities for and  
18 nature of the financial services offered by registered  
19 mutual funds.

20           (2) FULL-TIME INDEPENDENT SERVICE.—Each  
21 member of the Board shall serve on a full-time basis,  
22 and may not, concurrent with service on the Board,  
23 be employed by any other person or engage in any  
24 other professional or business activity. No member  
25 of the Board may share in any of the profits of,

1 or receive payments from, a mutual fund (or any  
 2 other person, as determined by rule of the Commis-  
 3 sion), other than fixed continuing payments, subject  
 4 to such conditions as the Commission may impose,  
 5 under standard arrangements for the retirement of  
 6 employees of mutual funds.

7 (3) APPOINTMENT OF BOARD MEMBERS.—

8 (A) INITIAL BOARD.—Not later than 90  
 9 days after the date of enactment of this Act,  
 10 the Commission, after consultation with the  
 11 Chairman of the Board of Governors of the  
 12 Federal Reserve System and the Secretary of  
 13 the Treasury, shall appoint the chairperson and  
 14 other initial members of the Board.

15 (B) VACANCIES.—A vacancy on the Board  
 16 shall not affect the powers of the Board, but  
 17 shall be filled in the same manner as provided  
 18 for appointments under this section.

19 (4) TERM OF SERVICE.—

20 (A) IN GENERAL.—The term of service of  
 21 each Board member shall be 5 years, and until  
 22 a successor is appointed, except that—

23 (i) the terms of office of the initial  
 24 Board members (other than the chair-  
 25 person) shall expire in annual increments,

1                   1 on each of the first 4 anniversaries of  
2                   the initial date of appointment; and

3                   (ii) any Board member appointed to  
4                   fill a vacancy occurring before the expira-  
5                   tion of the term for which the predecessor  
6                   was appointed shall be appointed only for  
7                   the remainder of that term.

8                   (B) TERM LIMITATION.—No person may  
9                   serve as a member of the Board, or as chair-  
10                  person of the Board, for more than 2 terms,  
11                  whether or not such terms of service are con-  
12                  secutive.

13                  (5) REMOVAL FROM OFFICE.—A member of the  
14                  Board may be removed by the Commission from of-  
15                  fice, in accordance with section 206(d)(3), for good  
16                  cause shown before the expiration of the term of  
17                  that member.

18                  (f) POWERS OF THE BOARD.—In addition to any au-  
19                  thority granted to the Board under this title, the Board  
20                  shall have the power, subject to section 206—

21                  (1) to sue and be sued, complain and defend, in  
22                  its corporate name and through its own counsel,  
23                  with the approval of the Commission, in any Fed-  
24                  eral, State, or other court;

1           (2) to conduct its operations and maintain of-  
2       fices, and to exercise all other rights and powers au-  
3       thorized by this title, in any State, without regard  
4       to any qualification, licensing, or other provision of  
5       law in effect in such State (or a political subdivision  
6       thereof);

7           (3) to lease, purchase, accept gifts or donations  
8       of, or otherwise acquire, improve, use, sell, exchange,  
9       or convey, all of or an interest in any property,  
10      wherever situated;

11          (4) to appoint such employees, accountants, at-  
12      torneys, and other agents as may be necessary or  
13      appropriate, and to determine their qualifications,  
14      define their duties, and fix their salaries or other  
15      compensation (at a level that is comparable to pri-  
16      vate sector self-regulatory, accounting, technical, su-  
17      pervisory, or other staff or management positions);

18          (5) to allocate, assess, and collect support fees  
19      established pursuant to section 209, for the Board,  
20      and other fees and charges imposed under this title;  
21      and

22          (6) to enter into contracts, execute instruments,  
23      incur liabilities, and do any and all other acts and  
24      things necessary, appropriate, or incidental to the  
25      conduct of its operations and the exercise of its obli-

1       gations, rights, and powers imposed or granted by  
2       this title.

3       (g) RULES OF THE BOARD.—The rules of the Board  
4 shall, subject to the approval of the Commission—

5           (1) provide for the operation and administration  
6       of the Board, the exercise of its authority, and the  
7       performance of its responsibilities under this title;

8           (2) permit, as the Board determines necessary  
9       or appropriate, delegation by the Board of any of its  
10      functions to an individual member or employee of  
11      the Board, or to a division of the Board, including  
12      functions with respect to hearing, determining, or-  
13      dering, certifying, reporting, or otherwise acting as  
14      to any matter, except that—

15           (A) the Board shall retain a discretionary  
16      right to review any action pursuant to any such  
17      delegated function, upon its own motion;

18           (B) a person shall be entitled to a review  
19      by the Board with respect to any matter so del-  
20      egated, and the decision of the Board upon  
21      such review shall be deemed to be the action of  
22      the Board for all purposes (including appeal or  
23      review thereof); and

24           (C) if the right to exercise a review de-  
25      scribed in subparagraph (A) is declined, or if no

1           such review is sought within the time stated in  
 2           the rules of the Board, then the action taken by  
 3           the holder of such delegation shall for all pur-  
 4           poses, including appeal or review thereof, be  
 5           deemed to be the action of the Board;

6           (3) establish ethics rules and standards of con-  
 7           duct for Board members and staff, including a bar  
 8           on practice before the Board (and the Commission,  
 9           with respect to Board-related matters) of 1 year for  
 10          former members of the Board, and appropriate peri-  
 11          ods (not to exceed 1 year) for former staff of the  
 12          Board; and

13          (4) provide as otherwise required by this title.

14          (h) ANNUAL REPORT TO THE COMMISSION.—

15           (1) IN GENERAL.—The Board shall submit an  
 16           annual report (including its audited financial state-  
 17           ments) to the Commission.

18           (2) SUBMISSION TO CONGRESS.—Not later than  
 19           30 days after the date of receipt of a report under  
 20           paragraph (1), the Commission shall transmit a copy  
 21           of that report to—

22                   (A) the Committee on Banking, Housing,  
 23                   and Urban Affairs of the Senate; and

24                   (B) the Committee on Financial Services  
 25                   of the House of Representatives.



1 **SEC. 202. REGISTRATION WITH THE BOARD.**

2 (a) MANDATORY REGISTRATION.—Beginning 180  
3 days after the date of the determination of the Commis-  
4 sion under section 201(d), it shall be unlawful for any mu-  
5 tual fund to conduct business if that mutual fund is not  
6 registered with the Board under this section.

7 (b) APPLICATIONS FOR REGISTRATION.—

8 (1) FORM OF APPLICATION.—A mutual fund  
9 shall use such form as the Board may prescribe, by  
10 rule, to apply for registration under this section.

11 (2) CONTENTS OF APPLICATIONS.—Each mu-  
12 tual fund shall submit, as part of its application for  
13 registration, in such detail as the Board shall speci-  
14 fy—

15 (A) the policies of each mutual fund re-  
16 garding, and efforts taken by that mutual fund  
17 to eliminate, market timing practices;

18 (B) the annual fees received by the mutual  
19 fund;

20 (C) such other current financial informa-  
21 tion for the most recently completed fiscal year  
22 of the mutual fund as the Board may reason-  
23 ably request;

24 (D) a statement of the quality control poli-  
25 cies of the mutual fund;

1 (E) the policies of each mutual fund re-  
2 garding, and efforts taken by that mutual fund  
3 to eliminate, late trading practices; and

4 (F) information relating to criminal, civil,  
5 or administrative actions or disciplinary pro-  
6 ceedings pending against the mutual fund or  
7 any associated person of the mutual fund in  
8 connection with the conduct of the mutual fund;  
9 and

10 (G) such other information as the rules of  
11 the Board or the Commission shall specify as  
12 necessary or appropriate in the public interest  
13 or for the protection of investors.

14 (3) CONSENTS.—Each application for registra-  
15 tion under this subsection shall include—

16 (A) a consent executed by the mutual fund  
17 to cooperation in and compliance with any re-  
18 quest for testimony or the production of docu-  
19 ments made by the Board in the furtherance of  
20 its authority and responsibilities under this title  
21 (and an agreement to secure and enforce simi-  
22 lar consents from each of the associated persons  
23 of the mutual fund as a condition of their con-  
24 tinued employment by or other association with  
25 such mutual fund); and

1 (B) a statement that such mutual fund un-  
2 derstands and agrees that cooperation and com-  
3 pliance, as described in the consent required by  
4 subparagraph (A), and the securing and en-  
5 forcement of such consents from its associated  
6 persons, in accordance with the rules of the  
7 Board, shall be a condition to the continuing ef-  
8 fectiveness of the registration of the mutual  
9 fund with the Board.

10 (c) ACTION ON APPLICATIONS.—

11 (1) TIMING.—The Board shall approve a com-  
12 pleted application for registration not later than 45  
13 days after the date of receipt of the application, in  
14 accordance with the rules of the Board, unless the  
15 Board, prior to such date, issues a written notice of  
16 disapproval to, or requests more information from,  
17 the prospective registrant.

18 (2) TREATMENT.—A written notice of dis-  
19 approval of a completed application under paragraph  
20 (1) for registration shall be treated as a disciplinary  
21 sanction for purposes of sections 205(d) and 206(c).

22 (d) PERIODIC REPORTS.—Each registered mutual  
23 fund shall submit an annual report to the Board, and may  
24 be required to report more frequently, as necessary to up-  
25 date the information contained in its application for reg-

1 istration under this section, and to provide to the Board  
 2 such additional information as the Board or the Commis-  
 3 sion may specify, in accordance with subsection (b)(2).

4 (e) PUBLIC AVAILABILITY.—Registration applica-  
 5 tions and annual reports required by this subsection, or  
 6 such portions of such applications or reports as may be  
 7 designated under rules of the Board, shall be made avail-  
 8 able for public inspection, subject to rules of the Board  
 9 or the Commission, and to applicable laws relating to the  
 10 confidentiality of proprietary, personal, or other informa-  
 11 tion contained in such applications or reports, provided  
 12 that, in all events, the Board shall protect from public dis-  
 13 closure information reasonably identified by the subject  
 14 mutual fund as proprietary information.

15 (f) REGISTRATION AND ANNUAL FEES.—The Board  
 16 shall assess and collect a registration fee and an annual  
 17 fee from each registered mutual fund, in amounts that are  
 18 sufficient to recover the costs of processing and reviewing  
 19 applications and annual reports.

20 **SEC. 203. AUDITING, QUALITY CONTROL, AND INDEPEND-**  
 21 **ENCE STANDARDS AND RULES.**

22 (a) AUDITING, QUALITY CONTROL, AND ETHICS  
 23 STANDARDS.—

24 (1) IN GENERAL.—The Board shall, by rule, es-  
 25 tablish such internal auditing and quality control

standards, and such ethics standards to be used by registered mutual funds in conducting their business, as required by this title or the rules of the Commission, or as may be necessary or appropriate in the public interest or for the protection of investors.

(2) RULE REQUIREMENTS.—In carrying out paragraph (1), the Board—

(A) shall include in the internal auditing standards that it adopts, requirements that each registered mutual fund shall—

(i) prepare, and maintain for a period of not less than 7 years, audit work papers, and other information related to any internal audit report, in sufficient detail to support the conclusions reached in such report; and

(ii) provide a concurring or second executive officer review and approval of such audit report (and other related information), and concurring approval in its issuance, by a qualified person (as prescribed by the Board) associated with the mutual fund, other than the person in

charge of the audit, or by an independent reviewer (as prescribed by the Board); and

(B) shall include in the quality control standards that it adopts with respect to the issuance of audit reports, requirements applicable to every registered mutual fund relating to—

(i) monitoring of professional ethics and quality standards;

(ii) consultation within such mutual fund on auditing questions;

(iii) supervision of internal audit work;

(iv) hiring, professional development, and advancement of audit personnel;

(v) internal inspection; and

(vi) such other requirements as the Board may prescribe, subject to paragraph (1).

(3) AUTHORITY TO ADOPT OTHER STANDARDS.—

(A) IN GENERAL.—The Board—

(i) may adopt as its rules, subject to section 206, any portion of any statement of professional standards that the Board

determines satisfy the requirements of paragraph (1), and that were proposed by 1 or more professional groups that shall be designated or recognized by the Board, by rule, for such purpose, pursuant to this paragraph or 1 or more advisory groups convened pursuant to paragraph (4); and

(ii) notwithstanding clause (i), shall retain full authority to modify, supplement, revise, or subsequently amend, modify, or repeal, in whole or in part, any portion of any statement described in clause (i).

(B) INITIAL AND TRANSITIONAL STANDARDS.—The Board shall adopt standards described in subparagraph (A)(i) as initial or transitional standards, to the extent the Board determines necessary, prior to a determination of the Commission under section 201(d), and such standards shall be separately approved by the Commission at the time of that determination, without regard to the procedures required by section 206 that otherwise would apply to the approval of rules of the Board.

(4) ADVISORY GROUPS.—The Board shall convene, or authorize its staff to convene, such expert

1 advisory groups as may be appropriate, which may  
 2 include representatives of the mutual fund industry  
 3 and other experts, as well as representatives of other  
 4 interested groups, subject to such rules as the Board  
 5 may prescribe to prevent conflicts of interest, to  
 6 make recommendations concerning the content (in-  
 7 cluding proposed drafts) of auditing, quality control,  
 8 ethics, independence, or other standards required to  
 9 be established under this section.

10 (b) INDEPENDENCE STANDARDS AND RULES.—The  
 11 Board shall establish such rules ensuring compliance with  
 12 section 10 of the Investment Company Act of 1940, as  
 13 may be necessary or appropriate in the public interest or  
 14 for the protection of investors.

15 (c) COOPERATION WITH DESIGNATED PROFES-  
 16 SIONAL GROUPS OF MUTUAL FUNDS AND ADVISORY  
 17 GROUPS.—

18 (1) IN GENERAL.—The Board shall—

19 (A) cooperate on an ongoing basis with  
 20 professional groups designated under subsection  
 21 (a)(3)(A) and advisory groups convened under  
 22 subsection (a)(4) in the examination of the need  
 23 for changes in any standards subject to its au-  
 24 thority under subsection (a);



1 (B) recommend issues for inclusion on the  
 2 agendas of such designated professional groups  
 3 or advisory groups; and

4 (C) take such other steps as it deems ap-  
 5 propriate to increase the effectiveness of the  
 6 standard setting process.

7 (2) BOARD RESPONSES.—The Board shall re-  
 8 spond in a timely fashion to requests from des-  
 9 ignated professional groups and advisory groups re-  
 10 ferred to in paragraph (1) for any changes in stand-  
 11 ards over which the Board has authority.

12 (d) EVALUATION OF STANDARD SETTING PROC-  
 13 ESS.—The Board shall include in the annual report re-  
 14 quired by section 201(h) the results of its standard setting  
 15 responsibilities during the period to which the report re-  
 16 lates, including a discussion of the work of the Board with  
 17 any designated professional groups and advisory groups  
 18 described in paragraphs (3)(A) and (4) of subsection (a),  
 19 and its pending issues agenda for future standard setting  
 20 projects.

21 **SEC. 204. INSPECTIONS OF REGISTERED MUTUAL FUNDS.**

22 (a) IN GENERAL.—The Board shall conduct a con-  
 23 tinuing program of inspections, at such intervals as are  
 24 established under the rules of the Board to assess the de-  
 25 gree of compliance of each registered mutual fund and as-

1 sociated persons of that mutual fund with this title, the  
2 rules of the Board, the rules of the Commission, or profes-  
3 sional standards.

4 (b) INSPECTION FREQUENCY.—

5 (1) IN GENERAL.—Subject to paragraph (2),  
6 inspections required by this section shall be con-  
7 ducted annually with respect to each registered mu-  
8 tual fund that is the basis for any difference be-  
9 tween these 2 standards.

10 (2) ADJUSTMENTS TO SCHEDULES.—The  
11 Board may, by rule, adjust the inspection schedules  
12 set under paragraph (1) if the Board finds that dif-  
13 ferent inspection schedules are consistent with the  
14 purposes of this title, the public interest, and the  
15 protection of investors.

16 (c) PROCEDURES.—The Board shall, in each inspec-  
17 tion under this section, and in accordance with its rules  
18 for such inspections—

19 (1) identify any act or practice or omission to  
20 act by the registered mutual fund, or by any associ-  
21 ated person thereof, revealed by such inspection that  
22 may be in violation of this title, the rules of the  
23 Board, the rules of the Commission, the quality con-  
24 trol policies of the mutual fund, or professional  
25 standards;

1           (2) report any such act, practice, or omission,  
2           if appropriate, to the Commission and each appro-  
3           priate State regulatory authority; and

4           (3) begin a formal investigation or take appro-  
5           priate disciplinary action, if any, with respect to any  
6           such violation, in accordance with this title and the  
7           rules of the Board.

8           (d) CONDUCT OF INSPECTIONS.—In conducting an  
9           inspection of a registered mutual fund under this section,  
10          the Board shall—

11           (1) inspect and review internal audits per-  
12           formed by the mutual fund;

13           (2) evaluate the sufficiency of the quality con-  
14           trol system of the mutual fund, and the manner of  
15           the documentation and communication of that sys-  
16           tem by the mutual fund; and

17           (3) perform such other testing of the internal  
18           audit, supervisory, and quality control procedures of  
19           the mutual fund as are necessary or appropriate in  
20           light of the purpose of the inspection and the re-  
21           sponsibilities of the Board.

22           (e) RECORD RETENTION.—The rules of the Board  
23           may require the retention by registered mutual funds for  
24           inspection purposes of records, the retention of which is

1 not otherwise required by section 203 or the rules issued  
2 thereunder.

3 (f) PROCEDURES FOR REVIEW.—

4 (1) REVIEW AND RESPONSE.—The rules of the  
5 Board shall provide a procedure for the review of  
6 and response to a draft inspection report by the reg-  
7 istered mutual fund under inspection.

8 (2) ACTION ON RESPONSE.—The Board shall  
9 take such action with respect to such response as it  
10 considers appropriate (including revising the draft  
11 report or continuing or supplementing its inspection  
12 activities before issuing a final report, as appro-  
13 priate). The text of any such response, appropriately  
14 redacted to protect information reasonably identified  
15 by the mutual fund as confidential, shall be attached  
16 to and made part of the inspection report.

17 (g) REPORT.—A written report of the findings of the  
18 Board for each inspection under this section, subject to  
19 subsection (h), shall be—

20 (1) transmitted, in appropriate detail, to the  
21 Commission and each appropriate State regulatory  
22 authority, accompanied by any letter or comments  
23 by the Board or the inspector, and any letter of re-  
24 sponse from the registered mutual fund; and

1           (2) made available in appropriate detail to the  
2           public (subject to section 205(b)(5)(A), and to the  
3           protection of such confidential and proprietary infor-  
4           mation as the Board may determine to be appro-  
5           priate, or as may be required by law), except that  
6           no portion of the inspection report that deals with  
7           criticisms of or potential defects in the quality con-  
8           trol systems of the mutual fund under inspection  
9           shall be made public if those criticisms or defects are  
10          addressed by the mutual fund, to the satisfaction of  
11          the Board, not later than 12 months after the date  
12          of the inspection report.

13          (h) INTERIM COMMISSION REVIEW.—

14                (1) REVIEWABLE MATTERS.—A registered mu-  
15                tual fund may seek review by the Commission, pur-  
16                suant to such rules as the Commission shall promul-  
17                gate, if the mutual fund—

18                    (A) has provided the Board with a re-  
19                    sponse, pursuant to rules issued by the Board  
20                    under subsection (f), to the substance of par-  
21                    ticular items in a draft inspection report, and  
22                    disagrees with the assessments contained in any  
23                    final report prepared by the Board following  
24                    such response; or

1 (B) disagrees with the determination of the  
 2 Board that criticisms or defects identified in an  
 3 inspection report have not been addressed to  
 4 the satisfaction of the Board within 12 months  
 5 after the date of the inspection report, for pur-  
 6 poses of subsection (g)(2).

7 (2) TREATMENT OF REVIEW.—Any decision of  
 8 the Commission with respect to a review under para-  
 9 graph (1) shall not be reviewable under section 25  
 10 of the Securities Exchange Act of 1934 (15 U.S.C.  
 11 78y), or deemed to be “final agency action” for pur-  
 12 poses of section 704 of title 5, United States Code.

13 (3) TIMING.—Review under paragraph (1) may  
 14 be sought during the 30-day period following the  
 15 date of the event giving rise to the review under sub-  
 16 paragraph (A) or (B) of paragraph (1).

17 **SEC. 205. INVESTIGATIONS AND DISCIPLINARY PRO-**  
 18 **CEEDINGS.**

19 (a) IN GENERAL.—The Board shall establish, by  
 20 rule, subject to the requirements of this section, fair proce-  
 21 dures for the investigation and disciplining of registered  
 22 mutual funds and associated persons of such mutual  
 23 funds.

24 (b) INVESTIGATIONS.—

1           (1) AUTHORITY.—In accordance with the rules  
2           of the Board, the Board may conduct an investiga-  
3           tion of any act or practice, or omission to act, by a  
4           registered mutual fund, any associated person of  
5           such mutual fund, or both, that may violate any pro-  
6           vision of this title, the rules of the Board, the provi-  
7           sions of the securities laws relating to mutual funds,  
8           or professional standards, regardless of how the act,  
9           practice, or omission is brought to the attention of  
10          the Board.

11          (2) TESTIMONY AND DOCUMENT PRODUC-  
12          TION.—In addition to such other actions as the  
13          Board determines to be necessary, the rules of the  
14          Board may—

15                (A) require the testimony of the registered  
16                mutual fund or of any person associated with a  
17                registered mutual fund, with respect to any  
18                matter that the Board considers relevant or  
19                material to an investigation;

20                (B) require the production of audit work  
21                papers and any other document or information  
22                in the possession of a registered mutual fund or  
23                any associated person thereof, wherever domi-  
24                ciled, that the Board considers relevant or ma-  
25                terial to the investigation, and may inspect the

1 books and records of such mutual fund or asso-  
2 ciated person to verify the accuracy of any doc-  
3 uments or information supplied;

4 (C) request the testimony of, and produc-  
5 tion of any document in the possession of, any  
6 other person, including any client of a reg-  
7 istered mutual fund that the Board considers  
8 relevant or material to an investigation under  
9 this section, with appropriate notice, subject to  
10 the needs of the investigation, as permitted  
11 under the rules of the Board; and

12 (D) provide for procedures to seek issuance  
13 by the Commission, in a manner established by  
14 the Commission, of a subpoena to require the  
15 testimony of, and production of any document  
16 in the possession of, any person, including any  
17 client of a registered mutual fund, that the  
18 Board considers relevant or material to an in-  
19 vestigation under this section.

20 (3) NONCOOPERATION WITH INVESTIGA-  
21 TIONS.—

22 (A) IN GENERAL.—If a registered mutual  
23 fund or any associated person thereof refuses to  
24 testify, produce documents, or otherwise cooper-



ate with the Board in connection with an investigation under this section, the Board may—

(i) suspend or bar such person from being associated with a registered mutual fund, or require the registered mutual fund to end such association;

(ii) suspend or revoke the registration of the mutual fund; and

(iii) invoke such other lesser sanctions as the Board considers appropriate, and as specified by rule of the Board.

(B) PROCEDURE.—Any action taken by the Board under this paragraph shall be subject to the terms of section 206(c).

(4) REFERRAL.—The Board may refer an investigation under this section—

(A) to the Commission; and

(B) at the direction of the Commission, to—

(i) the Attorney General of the United States;

(ii) the attorney general of 1 or more States; and

(iii) the appropriate State regulatory authority.

1 (5) USE OF DOCUMENTS.—

2 (A) CONFIDENTIALITY.—Except as pro-  
3 vided in subparagraph (B), all documents and  
4 information prepared or received by or specifi-  
5 cally for the Board, and deliberations of the  
6 Board and its employees and agents, in connec-  
7 tion with an inspection under section 204 or  
8 with an investigation under this section, shall  
9 be confidential and privileged as an evidentiary  
10 matter (and shall not be subject to civil dis-  
11 covery or other legal process) in any proceeding  
12 in any Federal or State court or administrative  
13 agency, and shall be exempt from disclosure, in  
14 the hands of an agency or establishment of the  
15 Federal Government, under the Freedom of In-  
16 formation Act (5 U.S.C. 552a), or otherwise,  
17 unless and until presented in connection with a  
18 public proceeding or released in accordance with  
19 subsection (c).

20 (B) AVAILABILITY TO GOVERNMENT AGEN-  
21 CIES.—All information referred to in subpara-  
22 graph (A) may, in the discretion of the Board,  
23 when determined by the Board to be necessary  
24 to accomplish the purposes of this title or to  
25 protect investors, and without the loss of its

1 status as confidential and privileged in the  
 2 hands of the Board, be made available to the  
 3 Commission, the Attorney General of the  
 4 United States, to State attorneys general in  
 5 connection with any criminal investigation, and  
 6 to any appropriate State regulatory authority,  
 7 which shall maintain such information as con-  
 8 fidential and privileged.

9 (6) IMMUNITY.—Any employee of the Board en-  
 10 gaged in carrying out an investigation under this  
 11 title shall be immune from any civil liability arising  
 12 out of such investigation in the same manner and to  
 13 the same extent as an employee of the Federal Gov-  
 14 ernment in similar circumstances.

15 (c) DISCIPLINARY PROCEDURES.—

16 (1) NOTIFICATION; RECORDKEEPING.—The  
 17 rules of the Board shall provide that in any pro-  
 18 ceeding by the Board to determine whether a reg-  
 19 istered mutual fund, or an associated person thereof,  
 20 should be disciplined, the Board shall—

21 (A) bring specific charges with respect to  
 22 the mutual fund or associated person;

23 (B) notify such mutual fund or associated  
 24 person of, and provide to the mutual fund or

1 associated person an opportunity to defend  
2 against, such charges; and

3 (C) keep a record of the proceedings.

4 (2) PUBLIC HEARINGS.—Hearings under this  
5 section shall be open to the public, unless otherwise  
6 ordered by the Board for good cause shown.

7 (3) SUPPORTING STATEMENT.—A determina-  
8 tion by the Board to impose a sanction under this  
9 subsection shall be supported by a statement setting  
10 forth—

11 (A) each act or practice in which the reg-  
12 istered mutual fund, or associated person, has  
13 engaged (or omitted to engage), or that forms  
14 a basis for all or a part of such sanction;

15 (B) the specific provision of this title, the  
16 securities laws, the rules of the Board, or pro-  
17 fessional standards which the Board determines  
18 has been violated; and

19 (C) the sanction imposed, including a jus-  
20 tification for that sanction.

21 (4) SANCTIONS.—If the Board finds, based on  
22 all of the facts and circumstances, that a registered  
23 mutual fund or associated person thereof has en-  
24 gaged in any act or practice, or omitted to act, in  
25 violation of this title, the rules of the Board, the

1 provisions of the securities laws relating to the prep-  
2 aration and issuance of audit reports and the obliga-  
3 tions and liabilities of accountants with respect  
4 thereto, including the rules of the Commission issued  
5 under this title, or professional standards, the Board  
6 may impose such disciplinary or remedial sanctions  
7 as it determines appropriate, subject to applicable  
8 limitations under paragraph (5), including—

9 (A) temporary suspension or permanent  
10 revocation of registration under this title;

11 (B) temporary or permanent suspension or  
12 bar of a person from further association with  
13 any registered mutual fund;

14 (C) temporary or permanent limitation on  
15 the activities, functions, or operations of such  
16 mutual fund or person (other than in connec-  
17 tion with required additional professional edu-  
18 cation or training);

19 (D) a civil money penalty for each such  
20 violation, in an amount equal to—

21 (i) not more than \$100,000 for a nat-  
22 ural person or \$2,000,000 for any other  
23 person; and

24 (ii) in any case to which paragraph  
25 (5) applies, not more than \$750,000 for a

1 natural person or \$15,000,000 for any  
 2 other person;

3 (E) censure;

4 (F) required additional professional edu-  
 5 cation or training; or

6 (G) any other appropriate sanction pro-  
 7 vided for in the rules of the Board.

8 (5) INTENTIONAL OR OTHER KNOWING CON-  
 9 DUCT.—The sanctions and penalties described in  
 10 subparagraphs (A) through (C) and (D)(ii) of para-  
 11 graph (4) shall only apply to—

12 (A) intentional or knowing conduct, includ-  
 13 ing reckless conduct, that results in violation of  
 14 the applicable statutory, regulatory, or profes-  
 15 sional standard; or

16 (B) repeated instances of negligent con-  
 17 duct, each resulting in a violation of the appli-  
 18 cable statutory, regulatory, or professional  
 19 standard.

20 (6) FAILURE TO SUPERVISE.—

21 (A) IN GENERAL.—The Board may impose  
 22 sanctions under this section on a registered mu-  
 23 tual fund or upon the supervisory personnel of  
 24 such mutual fund, if the Board finds that—

1 (i) the mutual fund has failed reason-  
2 ably to supervise an associated person, ei-  
3 ther as required by the rules of the Board  
4 relating to auditing or quality control  
5 standards, or otherwise, with a view to pre-  
6 venting violations of this Act, the rules of  
7 the Board, the provisions of the securities  
8 laws relating to mutual funds, including  
9 the rules of the Commission under this  
10 title, or professional standards; and

11 (ii) such associated person commits a  
12 violation of this title, or any of such rules,  
13 laws, or standards.

14 (B) RULE OF CONSTRUCTION.—No associ-  
15 ated person of a registered mutual fund shall be  
16 deemed to have failed to reasonably supervise  
17 any other person for purposes of subparagraph  
18 (A), if—

19 (i) there have been established in and  
20 for that mutual fund procedures, and a  
21 system for applying such procedures, that  
22 comply with applicable rules of the Board  
23 and that would reasonably be expected to  
24 prevent and detect any such violation by  
25 such associated person; and

1                   (ii) such person has reasonably dis-  
 2 charged the duties and obligations incum-  
 3 bent upon that person by reason of such  
 4 procedures and system, and had no reason-  
 5 able cause to believe that such procedures  
 6 and system were not being complied with.

7           (7) EFFECT OF SUSPENSION.—It shall be un-  
 8 lawful for any person that is suspended or barred  
 9 from being associated with a registered mutual fund  
 10 under this subsection willfully to become or remain  
 11 associated with any registered mutual fund, or for  
 12 any registered mutual fund that knew, or, in the ex-  
 13 ercise of reasonable care should have known, of the  
 14 suspension or bar, to permit such an association,  
 15 without the consent of the Board or the Commis-  
 16 sion.

17           (d) REPORTING OF SANCTIONS.—

18                   (1) RECIPIENTS.—If the Board imposes a dis-  
 19 ciplinary sanction, in accordance with this section,  
 20 the Board shall report the sanction to—

21                           (A) the Commission;

22                           (B) any appropriate State regulatory au-  
 23 thorities; and

24                           (C) the public (once any stay on the im-  
 25 position of such sanction has been lifted).



1           (2) CONTENTS.—The information reported  
2 under paragraph (1) shall include—

3                   (A) the name of the sanctioned person;

4                   (B) a description of the sanction and the  
5 basis for its imposition; and

6                   (C) such other information as the Board  
7 deems appropriate.

8       (e) STAY OF SANCTIONS.—

9           (1) IN GENERAL.—Application to the Commis-  
10 sion for review, or the institution by the Commission  
11 of review, of any disciplinary action of the Board  
12 shall operate as a stay of any such disciplinary ac-  
13 tion, unless and until the Commission orders (sum-  
14 marily or after notice and opportunity for hearing on  
15 the question of a stay, which hearing may consist  
16 solely of the submission of affidavits or presentation  
17 of oral arguments) that no such stay shall continue  
18 to operate.

19           (2) EXPEDITED PROCEDURES.—The Commis-  
20 sion shall establish for appropriate cases an expe-  
21 dited procedure for consideration and determination  
22 of the question of the duration of a stay pending re-  
23 view of any disciplinary action of the Board under  
24 this subsection.

1 **SEC. 206. COMMISSION OVERSIGHT OF THE BOARD.**

2 (a) GENERAL OVERSIGHT RESPONSIBILITY.—The  
3 Commission shall have oversight and enforcement author-  
4 ity over the Board, as provided in this title.

5 (b) RULES OF THE BOARD.—

6 (1) DEFINITION.—In this section, the term  
7 “proposed rule” means any proposed rule of the  
8 Board, and any modification of any such rule.

9 (2) PRIOR APPROVAL REQUIRED.—No rule of  
10 the Board shall become effective without prior ap-  
11 proval of the Commission in accordance with this  
12 section, other than as provided in section  
13 203(a)(3)(B) with respect to initial or transitional  
14 standards.

15 (3) APPROVAL CRITERIA.—The Commission  
16 shall approve a proposed rule, if it finds that the  
17 rule is consistent with the requirements of this title  
18 and the securities laws, or is necessary in the public  
19 interest or for the protection of investors.

20 (4) PROPOSED RULE PROCEDURES.—The provi-  
21 sions of paragraphs (1) through (3) of section 19(b)  
22 of the Securities Exchange Act of 1934 (15 U.S.C.  
23 78s(b)) shall govern the proposed rules of the  
24 Board, as fully as if the Board were a “registered  
25 securities association” for purposes of that section  
26 19(b), except that, for purposes of this paragraph—

1 (A) the phrase “consistent with the re-  
 2 quirements of this title and the rules and regu-  
 3 lations thereunder applicable to such organiza-  
 4 tion” in section 19(b)(2) of that Act shall be  
 5 deemed to read “consistent with the require-  
 6 ments of title II of the Mutual Fund Investor  
 7 Protection Act of 2003, and the rules and regu-  
 8 lations issued thereunder applicable to such or-  
 9 ganization, or as necessary in the public inter-  
 10 est or for the protection of investors”; and

11 (B) the phrase “otherwise in furtherance  
 12 of the purposes of this title” in section  
 13 19(b)(3)(C) of that Act shall be deemed to read  
 14 “otherwise in furtherance of the purposes of  
 15 title II of the Mutual Fund Investor Protection  
 16 Act of 2003”.

17 (5) COMMISSION AUTHORITY TO AMEND RULES  
 18 OF THE BOARD.—The provisions of section 19(c) of  
 19 the Securities Exchange Act of 1934 (15 U.S.C.  
 20 78s(c)) shall govern the abrogation, deletion, or ad-  
 21 dition to portions of the rules of the Board by the  
 22 Commission as fully as if the Board were a “reg-  
 23 istered securities association” for purposes of that  
 24 section 19(c), except that the phrase “to conform its  
 25 rules to the requirements of this title and the rules

1 and regulations thereunder applicable to such orga-  
 2 nization, or otherwise in furtherance of the purposes  
 3 of this title” in section 19(c) of that Act shall, for  
 4 purposes of this paragraph, be deemed to read “to  
 5 assure the fair administration of the Mutual Fund  
 6 Oversight Board, conform the rules promulgated by  
 7 that Board to the requirements of title II of the Mu-  
 8 tual Fund Investor Protection Act of 2002, or other-  
 9 wise further the purposes of that Act, the securities  
 10 laws, and the rules and regulations thereunder appli-  
 11 cable to that Board”.

12 (c) COMMISSION REVIEW OF DISCIPLINARY ACTION  
 13 TAKEN BY THE BOARD.—

14 (1) NOTICE OF SANCTION.—The Board shall  
 15 promptly file notice with the Commission of any  
 16 final sanction on any registered mutual fund or on  
 17 any associated person thereof, in such form and con-  
 18 taining such information as the Commission, by rule,  
 19 may prescribe.

20 (2) REVIEW OF SANCTIONS.—The provisions of  
 21 sections 19(d)(2) and 19(e)(1) of the Securities Ex-  
 22 change Act of 1934 (15 U.S.C. 78s (d)(2) and  
 23 (e)(1)) shall govern the review by the Commission of  
 24 final disciplinary sanctions imposed by the Board  
 25 (including sanctions imposed under section

1       205(b)(3) of this title for noncooperation in an in-  
2       vestigation of the Board), as fully as if the Board  
3       were a self-regulatory organization and the Commis-  
4       sion were the appropriate regulatory agency for such  
5       organization for purposes of those sections 19(d)(2)  
6       and 19(e)(1), except that, for purposes of this para-  
7       graph—

8               (A) section 205(e) of this title (rather than  
9               that section 19(d)(2)) shall govern the extent to  
10              which application for, or institution by the  
11              Commission on its own motion of, review of any  
12              disciplinary action of the Board operates as a  
13              stay of such action;

14             (B) references in that section 19(e)(1) to  
15             “members” of such an organization shall be  
16             deemed to be references to registered mutual  
17             funds;

18             (C) the phrase “consistent with the pur-  
19             poses of this title” in that section 19(e)(1) shall  
20             be deemed to read “consistent with the pur-  
21             poses of this title and title II of the Mutual  
22             Fund Investor Protection Act of 2002”;

23             (D) references to rules of the Municipal  
24             Securities Rulemaking Board in that section  
25             19(e)(1) shall not apply; and

1 (E) the reference to section 19(e)(2) of the  
 2 Securities Exchange Act of 1934 shall refer in-  
 3 stead to section 206(c)(3) of this title.

4 (3) COMMISSION MODIFICATION AUTHORITY.—  
 5 The Commission may enhance, modify, cancel, re-  
 6 duce, or require the remission of a sanction imposed  
 7 by the Board upon a registered mutual fund or asso-  
 8 ciated person thereof, if the Commission, having due  
 9 regard for the public interest and the protection of  
 10 investors, finds, after a proceeding in accordance  
 11 with this subsection, that the sanction—

12 (A) is not necessary or appropriate in fur-  
 13 therance of this title or the securities laws; or

14 (B) is excessive, oppressive, inadequate, or  
 15 otherwise not appropriate to the finding or the  
 16 basis on which the sanction was imposed.

17 (d) CENSURE OF THE BOARD; OTHER SANCTIONS.—

18 (1) RESCISSION OF BOARD AUTHORITY.—The  
 19 Commission, by rule, consistent with the public in-  
 20 terest, the protection of investors, and the other pur-  
 21 poses of this title and the securities laws, may re-  
 22 lieve the Board of any responsibility to enforce com-  
 23 pliance with any provision of this title, the securities  
 24 laws, the rules of the Board, or professional stand-  
 25 ards.

1           (2) CENSURE OF THE BOARD; LIMITATIONS.—

2           The Commission may, by order, as it determines  
3           necessary or appropriate in the public interest, for  
4           the protection of investors, or otherwise in further-  
5           ance of the purposes of this title or the securities  
6           laws, censure or impose limitations upon the activi-  
7           ties, functions, and operations of the Board, if the  
8           Commission finds, on the record, after notice and  
9           opportunity for a hearing, that the Board—

10                   (A) has violated or is unable to comply  
11                   with any provision of this title, the rules of the  
12                   Board, or the securities laws; or

13                   (B) without reasonable justification or ex-  
14                   cuse, has failed to enforce compliance with any  
15                   such provision or rule, or any professional  
16                   standard by a registered mutual fund or an as-  
17                   sociated person thereof.

18           (3) CENSURE OF BOARD MEMBERS; REMOVAL

19           FROM OFFICE.—The Commission may, as necessary  
20           or appropriate in the public interest, for the protec-  
21           tion of investors, or otherwise in furtherance of the  
22           purposes of this title or the securities laws, remove  
23           from office or censure any member of the Board, if  
24           the Commission finds, on the record, after notice  
25           and opportunity for a hearing, that such member—

1 (A) has willfully violated any provision of  
2 this title, the rules of the Board, or the securi-  
3 ties laws;

4 (B) has willfully abused the authority of  
5 that member; or

6 (C) without reasonable justification or ex-  
7 cuse, has failed to enforce compliance with any  
8 such provision or rule, or any professional  
9 standard by any registered mutual fund or any  
10 associated person thereof.

11 **SEC. 207. FUNDING.**

12 (a) IN GENERAL.—The Board shall be funded as pro-  
13 vided in this section.

14 (b) ANNUAL BUDGETS.—The Board shall establish  
15 a budget for each fiscal year, which shall be reviewed and  
16 approved according to procedures established by the  
17 Board, not less than 1 month prior to the commencement  
18 of the fiscal year to which the budget pertains. The budget  
19 of the Board shall be subject to approval by the Commis-  
20 sion.

21 (c) SOURCES AND USES OF FUNDS.—The budget of  
22 the Board (reduced by any registration or annual fees re-  
23 ceived under section 202(e) for the year preceding the year  
24 for which the budget is being computed), for each fiscal



1 year shall be payable from annual support fees, in accord-  
 2 ance with subsection (d).

3 (d) ANNUAL SUPPORT FEE FOR THE BOARD.—

4 (1) ESTABLISHMENT OF FEE.—The Board shall  
 5 establish, with the approval of the Commission, a  
 6 reasonable annual support fee (or a formula for the  
 7 computation thereof), as may be necessary or appro-  
 8 priate to establish and maintain the Board.

9 (2) ASSESSMENTS.—The rules of the Board  
 10 under paragraph (1) shall provide for the equitable  
 11 allocation, assessment, and collection by the Board  
 12 (or an agent appointed by the Board) of the fee es-  
 13 tablished under paragraph (1), among mutual funds,  
 14 in accordance with subsection (f), allowing for dif-  
 15 ferentiation among classes of mutual funds, as ap-  
 16 propriate.

17 (e) ALLOCATION OF SUPPORT FEES AMONG MUTUAL  
 18 FUNDS.—Any amount due from mutual funds (or a par-  
 19 ticular class of mutual funds) under this section to fund  
 20 the budget of the Board shall be allocated among and pay-  
 21 able by each mutual fund (or each mutual fund in a par-  
 22 ticular class, as applicable) in an amount equal to the total  
 23 of such amount, multiplied by a fraction—

24 (1) the numerator of which is the average  
 25 monthly equity market capitalization of the mutual

1 fund for the 12-month period immediately preceding  
2 the beginning of the fiscal year to which such budget  
3 relates; and

4 (2) the denominator of which is the average  
5 monthly equity market capitalization of all such mu-  
6 tual funds for such 12-month period.

7 (f) RULE OF CONSTRUCTION.—Nothing in this sec-  
8 tion shall be construed to render the Board subject to pro-  
9 cedures in Congress to authorize or appropriate public  
10 funds, or to prevent such organization from utilizing addi-  
11 tional sources of revenue for its activities, such as earnings  
12 from publication sales, provided that each additional  
13 source of revenue shall not jeopardize, in the judgment  
14 of the Commission, the actual and perceived independence  
15 of such organization.

16 **SEC. 208. NO PREEMPTION OF STATE SECURITIES ACTIONS.**

17 No action taken by the Mutual Fund Oversight  
18 Board shall preempt any State securities investigation or  
19 enforcement action, or any State law, regulation, order,  
20 interpretation, or other action related to corporate govern-  
21 ance or antitrust, provided such corporate governance or  
22 antitrust law, regulation, order, interpretation, or other  
23 action is of general applicability.

1 **SEC. 209. ARBITRATION OF INVESTOR CLAIMS IN AN INDE-**  
2 **PENDENT FORUM.**

3 Not later than 270 days after the date of enactment  
4 of this Act, the Commission shall prescribe rules under  
5 the Securities Act of 1933, the Securities Exchange Act  
6 of 1934, the Investment Company Act of 1940, and the  
7 Investment Advisers Act of 1940, as appropriate, to be  
8 adopted by the Commission, any self-regulatory organiza-  
9 tion, or both, requiring that complainants who bring  
10 claims under such Acts shall have the option, at the time  
11 the complaint is filed, to have any arbitration of that com-  
12 plaint held in an independent arbitration forum the com-  
13 plainant chooses.

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