

109<sup>TH</sup> CONGRESS  
1<sup>ST</sup> SESSION

# S. 1037

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

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IN THE SENATE OF THE UNITED STATES

MAY 16, 2005

Mr. AKAKA 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 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 2005”.

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 “(13) 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) REVENUE SHARING.—The term ‘com-  
21 pensation’ under subparagraph (A) shall in-  
22 clude any direct or indirect payment made by  
23 an investment adviser (or any affiliate of an in-  
24 vestment adviser) to a broker or dealer for the  
25 purpose of promoting the sales of securities of  
26 an open-end company.

1           “(C) TIMING OF DISCLOSURE.—The dislo-  
2           sure required under subparagraph (A) shall be  
3           made to a customer not later than as of the  
4           date of the completion of the transaction.

5           “(D) LIMITATION.—The disclosures re-  
6           quired under subparagraph (A) may not be  
7           made exclusively in—

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

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

12           “(E) COMMISSION AUTHORITY.—

13                   “(i) IN GENERAL.—The Commission  
14                   shall promulgate such final rules as are  
15                   necessary to carry out this paragraph not  
16                   later than 1 year after the date of enact-  
17                   ment of the Mutual Fund Transparency  
18                   Act of 2005.

19                   “(ii) FORM OF DISCLOSURE.—Disclo-  
20                   sures under this paragraph shall be in  
21                   such form as the Commission, by rule,  
22                   shall require.

23           “(F) DEFINITION.—In this paragraph, the  
24           term ‘open-end company’ has the same meaning

1 as in section 5 of the Investment Company Act  
2 of 1940 (15 U.S.C. 80a-5).”.

3 (b) DISCLOSURE OF BROKERAGE COMMISSIONS.—  
4 Section 30 of the Investment Company Act of 1940 (15  
5 U.S.C. 80a-29) is amended by adding at the end the fol-  
6 lowing:

7 “(k) DISCLOSURE OF BROKERAGE COMMISSIONS.—  
8 The Commission, by rule, shall require that brokerage  
9 commissions as an aggregate dollar amount and percent-  
10 age of assets paid by an open-end company be included  
11 in any disclosure of the amount of fees and expenses that  
12 may be payable by the holder of the securities of such com-  
13 pany for purposes of—

14 “(1) the registration statement of that open-end  
15 company; and

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

19 **SEC. 3. MUTUAL FUND GOVERNANCE.**

20 (a) INDEPENDENT FUND BOARDS.—Section 10(a) of  
21 the Investment Company Act of 1940 (15 U.S.C. 80a-  
22 10(a)) is amended—

23 (1) by striking “shall have” and inserting the  
24 following: “shall—

25 “(1) have”;

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

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

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

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

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

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

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

1 (b) ACTION BY INDEPENDENT DIRECTORS.—Section  
2 10 of the Investment Company Act of 1940 (15 U.S.C.  
3 80a–10) is amended by adding at the end the following:

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

8 “(j) INDEPENDENT COMMITTEE.—

9 “(1) IN GENERAL.—The members of the board  
10 of directors of a registered investment company who  
11 are not interested persons of such registered invest-  
12 ment company shall establish a committee comprised  
13 solely of such members, which committee shall be re-  
14 sponsible for—

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

17 “(B) adopting qualification standards for  
18 the nomination of directors.

19 “(2) DISCLOSURE.—The standards developed  
20 under paragraph (1)(B) shall be disclosed in the reg-  
21 istration statement of the registered investment com-  
22 pany.”.

23 (c) DEFINITION OF INTERESTED PERSON.—Section  
24 2(a)(19) of the Investment Company Act of 1940 (15  
25 U.S.C. 80a–2) is amended—

1 (1) in subparagraph (A)—

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

4 (B) by striking clause (vii) and inserting  
5 the following:

6 “(vii) any natural person who has  
7 served as an officer or director, or as an  
8 employee within the preceding 10 fiscal  
9 years, of an investment adviser or principal  
10 underwriter to such registered investment  
11 company, or of any entity controlling, con-  
12 trolled by, or under common control with  
13 such investment adviser or principal under-  
14 writer;

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

24 “(ix) any natural person who is a  
25 member of a class of persons that the

1 Commission, by rule or regulation, deter-  
2 mines is unlikely to exercise an appropriate  
3 degree of independence as a result of—

4 “(I) a material business relation-  
5 ship with the investment company or  
6 an affiliated person of such invest-  
7 ment company;

8 “(II) a close familial relationship  
9 with any natural person who is an af-  
10 filiated person of such investment  
11 company; or

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

14 (2) in subparagraph (B)—

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

17 (B) by striking clause (vii) and inserting  
18 the following:

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

24 “(I) a material business relation-  
25 ship with such investment adviser or

1 principal underwriter or affiliated per-  
 2 son of such investment adviser or  
 3 principal underwriter;

4 “(II) a close familial relationship  
 5 with any natural person who is an af-  
 6 filiated person of such investment ad-  
 7 viser or principal underwriter; or

8 “(III) any other reason as deter-  
 9 mined by the Commission:”.

10 (d) DEFINITION OF SIGNIFICANT SERVICE PRO-  
 11 VIDER.—Section 2(a) of the Investment Company Act of  
 12 1940 (15 U.S.C. 80a-2(a)) is amended by adding at the  
 13 end the following:

14 “(53) SIGNIFICANT SERVICE PROVIDER.—

15 “(A) IN GENERAL.—Not later than 270  
 16 days after the date of enactment of the Mutual  
 17 Fund Transparency Act of 2005, the Securities  
 18 and Exchange Commission shall issue final  
 19 rules defining the term ‘significant service pro-  
 20 vider’.

21 “(B) REQUIREMENTS.—The definition de-  
 22 veloped under paragraph (1) shall include, at a  
 23 minimum, the investment adviser and principal  
 24 underwriter of a registered investment company  
 25 for purposes of paragraph (19).”.

1 **SEC. 4. FINANCIAL LITERACY AMONG MUTUAL FUND IN-**  
2 **VESTORS STUDY.**

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

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

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

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

16 (4) the existing private and public efforts to  
17 educate investors; and

18 (5) a strategy to increase the financial literacy  
19 of investors that results in a positive change in in-  
20 vestor behavior.

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

25 (1) the Committee on Banking, Housing, and  
26 Urban Affairs of the Senate; and

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

3 **SEC. 5. STUDY REGARDING MUTUAL FUND ADVERTISING.**

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

7                 (1) existing and proposed regulatory require-  
8                 ments for open-end investment company advertise-  
9                 ments;

10                (2) current marketing practices for the sale of  
11                open-end investment company shares, including the  
12                use of unsustainable past performance data, funds  
13                that have merged, and incubator funds;

14                (3) the impact of such advertising on con-  
15                sumers; and

16                (4) recommendations to improve investor pro-  
17                tections in mutual fund advertising and additional  
18                information necessary to ensure that investors can  
19                make informed financial decisions when purchasing  
20                shares.

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

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

3           (2) the Committee on Financial Services of the  
4           House of Representatives.

5 **SEC. 6. POINT-OF-SALE DISCLOSURE.**

6           (a) IN GENERAL.—Section 15(b) of the Securities  
7           Exchange Act of 1934 (15 U.S.C. 78o(b)), as amended  
8           by section 2, is amended by adding at the end the fol-  
9           lowing:

10           “(14) BROKER DISCLOSURES IN MUTUAL FUND  
11           TRANSACTIONS.—

12           “(A) IN GENERAL.—Each broker shall dis-  
13           close in writing to each person that purchases  
14           the shares of an investment company registered  
15           under section 8 of the Investment Company Act  
16           of 1940 (15 U.S.C. 80a-8)—

17           “(i) the source and amount, in dollars  
18           and as a percentage of assets, of any com-  
19           pensation received or to be received by the  
20           broker in connection with such transaction  
21           from any sources;

22           “(ii) the amount, in dollars and as a  
23           percentage of assets, of compensation re-  
24           ceived in connection with transactions in  
25           shares of other investment company shares

1           offered by the broker, if materially dif-  
2           ferent from the amount under (i);

3           “(iii) comparative information that  
4           shows the average amount received by bro-  
5           kers in connection with comparable trans-  
6           actions, as determined by the Commission;  
7           and

8           “(iv) such other information as the  
9           Commission determines appropriate.

10          “(B) REVENUE SHARING.—The term ‘com-  
11          pensation’ under subparagraph (A) shall in-  
12          clude any direct or indirect payment made by  
13          an investment adviser (or any affiliate of an in-  
14          vestment adviser) to a broker or dealer for the  
15          purpose of promoting the sales of securities of  
16          a registered investment company.

17          “(C) TIMING OF DISCLOSURE.—The disclo-  
18          sures required under subparagraph (A) shall be  
19          made to permit the person purchasing the  
20          shares to evaluate such disclosures before decid-  
21          ing to engage in the transaction.

22          “(D) LIMITATION.—The disclosures re-  
23          quired under subparagraph (A) may not be  
24          made exclusively in—

1           “(i) a registration statement or pro-  
2           spectus of a registered investment com-  
3           pany; or

4           “(ii) any other filing of a registered  
5           investment company with the Commission.

6           “(E) COMMISSION AUTHORITY.—The Com-  
7           mission shall promulgate such final rules as are  
8           necessary to carry out this paragraph not later  
9           than 1 year after the date of enactment of the  
10          Mutual Fund Transparency Act of 2005.”.

11          (b) NATIONAL SECURITIES ASSOCIATION REQUIRE-  
12          MENTS.—Section 15A of the Securities Exchange Act of  
13          1934 (15 U.S.C. 78o-3) is amended by adding at the end  
14          the following:

15          “(n) NATIONAL SECURITIES ASSOCIATION REQUIRE-  
16          MENTS.—Each national securities association registered  
17          pursuant to this section shall issue such rules as necessary  
18          not later than 1 year after the date of enactment of the  
19          Mutual Fund Transparency Act of 2005 to require that  
20          a broker that provides individualized investment advice to  
21          a person shall—

22                  “(1) have a fiduciary duty to that person;

23                  “(2) act solely in the best interests of that per-  
24          son; and

1           “(3) fully disclose all potential conflicts of inter-  
2           est and other information that is material to the re-  
3           lationship to that person prior to the time that the  
4           investment advice is first provided to the person and  
5           at least annually thereafter.”.

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