

# **S.2059**

## **Mutual Fund Reform Act of 2004 (Introduced in Senate)**

S 2059 IS

108th CONGRESS

2d Session

**S. 2059**

To improve the governance and regulation of mutual funds under the securities laws, and for other purposes.

**IN THE SENATE OF THE UNITED STATES**

**February 10, 2004**

Mr. FITZGERALD (for himself, Mr. LEVIN, and Ms. COLLINS) 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 improve the governance and regulation of mutual funds under the securities laws, and for other purposes.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

### **SECTION 1. SHORT TITLE; TABLE OF CONTENTS.**

(a) SHORT TITLE- This Act may be cited as the 'Mutual Fund Reform Act of 2004'.

(b) TABLE OF CONTENTS- The table of contents for this Act is as follows:

Sec. 1. Short title; table of contents.

Sec. 2. Definitions.

Sec. 3. Rulemaking.

### **TITLE I--FUND GOVERNANCE**

Sec. 110. Independent directors.

Sec. 111. Study of director compensation and independence.

Sec. 112. Fiduciary duties of directors.

Sec. 113. Fiduciary duty of investment adviser.

Sec. 114. Termination of fund advisers.

Sec. 115. Independent accounting and auditing.

Sec. 116. Prevention of fraud; internal compliance and control procedures.

## **TITLE II--FUND TRANSPARENCY**

Sec. 210. Cost consolidation and clarity.

Sec. 211. Advisor compensation and ownership of fund shares.

Sec. 212. Point of sale and additional disclosure of broker compensation.

Sec. 213. Breakpoint discounts.

Sec. 214. Portfolio turnover ratio.

Sec. 215. Proxy voting policies and record.

Sec. 216. Customer information from account intermediaries.

Sec. 217. Advertising.

## **TITLE III--FUND REGULATION AND OVERSIGHT**

Sec. 310. Prohibition of asset-based distribution expenses.

Sec. 311. Prohibition on revenue sharing, directed brokerage, and soft dollar arrangements.

Sec. 312. Market timing.

Sec. 313. Elimination of stale prices.

Sec. 314. Prohibition of short term trading; mandatory redemption fees.

Sec. 315. Prevention of after-hours trading.

Sec. 316. Ban on joint management of mutual funds and hedge funds.

Sec. 317. Selective disclosures.

## **TITLE IV--STUDIES**

Sec. 410. Study of adviser conflict of interest.

Sec. 411. Study of coordination of enforcement efforts.

Sec. 412. Study of Commission organizational structure.

Sec. 413. Trends in arbitration clauses.

Sec. 414. Hedge fund regulation.

Sec. 415. Investor education and the Internet.

## **SEC. 2. DEFINITIONS.**

In this Act, the following definitions shall apply:

(1) COMMISSION- The term `Commission' means the Securities and Exchange Commission.

(2) INVESTMENT ADVISER- The term `investment adviser' has the same meaning as in section 2(a)(20) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(20)).

(3) INVESTMENT COMPANY--The term `investment company' has the same meaning as in section 3 of the Investment Company Act of 1940 (15 U.S.C. 80-3).

(4) REGISTERED INVESTMENT COMPANY- The term `registered investment company' means an investment company that is registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8).

## **SEC. 3. RULEMAKING.**

(a) TIMING- Unless otherwise specified in this Act or the amendments made by this Act, the Commission shall issue, in final form, all rules and regulations required by this Act and the amendments made by this Act not later than 180 days after the date of enactment of this Act.

(b) AUTHORITY TO DEFINE TERMS- The Commission may, in issuing rules and regulations under this Act or the amendments made by this Act, define any term used in this Act or such amendments that is not otherwise defined for purposes of this Act or such amendment, as the Commission determines necessary and appropriate.

(c) EXEMPTION AUTHORITY- The Commission may, in issuing rules and regulations under this Act or the amendments made by this Act, exempt any investment company or other person from the application of such rules, as the Commission determines is necessary and appropriate, in the public interest or for the protection of investors.

### **TITLE I--FUND GOVERNANCE**

## **SEC. 110. INDEPENDENT DIRECTORS.**

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

(1) by striking `shall have' and inserting the following: `shall--

`(1) have';

(2) by striking '60 per centum' and inserting '25 percent';

(3) by striking the period at the end and inserting a semicolon; and

(4) by adding at the end the following:

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

(3) have as a member of its board of directors any person that is not an interested person of such registered investment company--

(A) who has served without being approved or elected by the shareholders of such registered investment company at least once every 5 years; and

(B) unless such director has been found, on an annual basis, by a majority of the directors who are not interested persons, after reasonable inquiry by such directors, not to have any material business or familial relationship with the registered investment company, a significant service provider to the company, or any entity controlling, controlled by, or under common control with such service provider, that is likely to impair the independence of the director.'

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

(i) INDEPENDENT COMMITTEE-

(1) IN GENERAL- The members of the board of directors of a registered investment company who are not interested persons of such registered investment company shall establish a committee comprised solely of such members, which committee shall be responsible for--

(A) selecting persons to be nominated for election to the board of directors;

(B) adopting qualification standards for the nomination of directors; and

(C) determining the compensation to be paid to directors.

(2) DISCLOSURE- The standards developed under paragraph (1)(B) shall be disclosed in the registration statement of the registered investment company.'

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

(1) in subparagraph (A)--

(A) in clause (iv), by striking 'two' and inserting '5'; and

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

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

an employee within the preceding 10 fiscal years, of an investment adviser or principal underwriter to such registered investment company, or of any entity controlling, controlled by, or under common control with such investment adviser or principal underwriter;

`(viii) any natural person who has served as an officer or director, or as an employee within the preceding 10 fiscal years, of any entity that has within the preceding 5 fiscal years acted as a significant service provider to such registered investment company, or of any entity controlling, controlled by, or under the common control with such service provider;

`(ix) any natural person who is a member of a class of persons that the Commission, by rule or regulation, determines is unlikely to exercise an appropriate degree of independence as a result of--

`(I) a material business relationship with the investment company or an affiliated person of such investment company;

`(II) a close familial relationship with any natural person who is an affiliated person of such investment company; or

`(III) any other reason determined by the Commission.';

(2) in subparagraph (B)--

(A) in clause (iv), by striking `two' and inserting `5'; and

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

`(vii) any natural person who is a member of a class of persons that the Commission, by rule or regulation, determines is unlikely to exercise an appropriate degree of independence as a result of--

`(I) a material business relationship with such investment adviser or principal underwriter or affiliated person of such investment adviser or principal underwriter;

`(II) a close familial relationship with any natural person who is an affiliated person of such investment adviser or principal underwriter; or

`(III) any other reason as determined by the Commission.'.

(d) DEFINITION OF SIGNIFICANT SERVICE PROVIDER- Section 2(a) of the Investment Company Act of 1940 is amended by adding at the end the following:

`(53) SIGNIFICANT SERVICE PROVIDER-

`(A) IN GENERAL- Not later than 270 days after the date of enactment of the

Mutual Fund Reform Act of 2004, the Commission shall issue final rules defining the term `significant service provider'.

`(B) REQUIREMENTS- The definition developed under paragraph (1) shall include, at a minimum, the investment adviser and principal underwriter of a registered investment company for purposes of paragraph (19).'

## **SEC. 111. STUDY OF DIRECTOR COMPENSATION AND INDEPENDENCE.**

(a) IN GENERAL- The Commission shall conduct a study of--

(1) whether any limits should be placed upon the amount of compensation paid by a registered investment company or any affiliate of such company to a director thereof; and

(2) whether a director of a registered investment company who is otherwise not an interested person of a registered investment company, as defined in section 2(a)(19) of the Investment Company Act of 1940, as amended by this Act, but serves as a director of multiple registered investment companies, or receives substantial compensation from the investment adviser of any such company, should be considered an `interested person' for purposes of section 2 of the Investment Company Act of 1940.

(b) REPORT- Not later than 1 year after the date of enactment of this Act, the Commission shall submit a report regarding the study conducted under subsection (a) to--

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

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

## **SEC. 112. FIDUCIARY DUTIES OF DIRECTORS.**

Section 10 of the Investment Company Act of 1940 (15 U.S.C. 80a-10), as amended by this Act, is amended by adding at the end the following:

`(j) FIDUCIARY DUTY OF DIRECTORS-

`(1) IN GENERAL- The members of the board of directors of a registered investment company shall have a fiduciary duty to act with loyalty and care, in the best interests of the shareholders.

`(2) RULEMAKING- The Commission shall promulgate rules to clarify the scope of the fiduciary duty under paragraph (1), which rules shall, at a minimum, require the directors of a registered investment company to--

`(A) determine the extent to which independent and reliable sources of information are sufficient to discharge director responsibilities;

`(B) negotiate management and advisory fees with due regard for the actual

cost of such services, including economies of scale;

`(C) evaluate the totality of fees with reference to the interests of shareholders;

`(D) evaluate the quality of the management of the company and potentially superior alternatives;

`(E) evaluate the quality, comprehensiveness, and clarity of disclosures to shareholders regarding costs;

`(F) evaluate any distribution or marketing plan of the company, including its costs and benefits;

`(G) evaluate the size of the portfolio of the company and its suitability to the interests of shareholders;

`(H) implement and monitor policies to ensure compliance with applicable securities laws; and

`(I) implement and monitor policies with respect to predatory trading practices.'.

### **SEC. 113. FIDUCIARY DUTY OF INVESTMENT ADVISER.**

Section 36 of the Investment Company Act of 1940 (15 U.S.C. 80a-35(b)) is amended--

(1) by redesignating subsection (c) as subsection (d); and

(2) by inserting after subsection (b) the following:

`(c) DUTIES WITH RESPECT TO COMPENSATION AND PROVISION OF INFORMATION- For purposes of subsections (a) and (b), the fiduciary duty of an investment adviser--

`(1) with respect to any compensation received, may require reasonable reference to the actual costs of the adviser and economies of scale; and

`(2) shall include a duty to supply such material information as is necessary for the independent directors of a registered investment company with whom the adviser is employed to review and govern such company.'.

### **SEC. 114. TERMINATION OF FUND ADVISER.**

The Commission shall promulgate such rules as it determines necessary in the public interest or for the protection of investors to facilitate the process through which the independent directors of a registered investment company may terminate the services of the investment adviser of such company in the good faith exercise of their fiduciary duties, without undue exposure to financial or litigation risk.

## SEC. 115. INDEPENDENT ACCOUNTING AND AUDITING.

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

(1) in subsection (a)--

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

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

`(2) such selection shall have been submitted for ratification or rejection at the next succeeding annual meeting of stockholders if such meeting be held, except that any vacancy occurring between annual meetings, due to the death or resignation of the accountant, may be filled by the vote of a majority of the members of the audit committee of such registered company, cast in person at a meeting called for the purpose of voting on such action;'; and

(B) by adding at the end the following: `The Commission, by rule, regulation, or order, may exempt a registered management company or registered face-amount certificate company otherwise subject to this subsection from the requirement in paragraph (1) that the votes by the members of the audit committee be cast at a meeting in person, when such a requirement is impracticable, subject to such conditions as the Commission may require.'; and

(2) by adding at the end the following:

`(d) AUDIT COMMITTEE REQUIREMENTS-

`(1) REQUIREMENTS AS PREREQUISITE TO FILING FINANCIAL STATEMENTS- Any registered management company or registered face-amount certificate company that files with the Commission any financial statement signed or certified by an independent public accountant shall comply with the requirements of paragraphs (2) through (6) of this subsection and any rule or regulation of the Commission issued thereunder.

`(2) RESPONSIBILITY RELATING TO INDEPENDENT PUBLIC ACCOUNTANTS- The audit committee of the registered investment company, in its capacity as a committee of the board of directors,

shall be directly responsible for the appointment, compensation, and oversight of the work of any independent public accountant employed by the registered investment company (including resolution of disagreements between management and the auditor regarding financial reporting) for the purpose of preparing or issuing the audit report or related work, and each such

independent public accountant shall report directly to the audit committee.

`(3) INDEPENDENCE-

`(A) IN GENERAL- Each member of the audit committee of the registered investment company shall be a member of the board of directors of the company, and shall otherwise be independent.

`(B) CRITERIA- In order to be considered to be independent for purposes of this paragraph, a member of an audit committee of a registered investment company may not, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board committee--

`(i) accept any consulting, advisory, or other compensatory fee from the registered investment company or the investment adviser or principal underwriter of the registered investment company; or

`(ii) be an interested person of the registered investment company.

`(4) COMPLAINTS- The audit committee of the registered investment company shall establish procedures for--

`(A) the receipt, retention, and treatment of complaints received by the registered investment company regarding accounting, internal accounting controls, or auditing matters; and

`(B) the confidential, anonymous submission by employees of the registered investment company and its investment adviser or principal underwriter of concerns regarding questionable accounting or auditing matters.

`(5) AUTHORITY TO ENGAGE ADVISERS- The audit committee of the registered investment company shall have the authority to engage independent counsel and other advisers, as it determines necessary to carry out its duties.

`(6) FUNDING- The registered investment company shall provide appropriate funding, as determined by the audit committee, in its capacity as a committee of the board of directors, for payment of compensation--

`(A) to the independent public accountant employed by the registered investment company for the purpose of rendering or issuing the audit report; and

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

`(7) AUDIT COMMITTEE- For purposes of this subsection, the term 'audit committee' means--

`(A) a committee (or equivalent body) established by and amongst the board of directors of a registered investment company for the purpose of overseeing the accounting and financial reporting processes of the company and audits of

the financial statements of the company; and

`(B) if no such committee exists with respect to a registered investment company, the entire board of directors of the company.'

(b) CONFORMING AMENDMENT- Section 10A(m) of the Securities Exchange Act of 1934 (15 U.S.C. 78j-1(m)) is amended by adding at the end the following:

`(7) EXEMPTION FOR INVESTMENT COMPANIES- Effective one year after the date of enactment of the Mutual Fund Reform Act of 2004, for purposes of this subsection, the term `issuer' shall not include any investment company that is registered under section 8 of the Investment Company Act of 1940.'

(c) IMPLEMENTATION- The Commission shall issue final regulations to carry out section 32(d) of the Investment Company Act of 1940, as added by subsection (a) of this section.

## **SEC. 116. PREVENTION OF FRAUD; INTERNAL COMPLIANCE AND CONTROL PROCEDURES.**

(a) DETECTION AND PREVENTION OF FRAUD- Section 17(j) of the Investment Company Act of 1940 (15 U.S.C. 80a-17(j)) is amended to read as follows:

`(j) DETECTION AND PREVENTION OF FRAUD-

`(1) COMMISSION RULES TO PROHIBIT FRAUD, DECEPTION, AND MANIPULATION- It shall be unlawful for any affiliated person of or principal underwriter for a registered investment company or any affiliated person of an investment adviser of or principal underwriter for a registered investment company, to engage in any act, practice, or course of business in connection with the purchase or sale, directly or indirectly, by such person of any security held or to be acquired by such registered investment company, or any security issued by such registered investment company or by an affiliated registered investment company, in contravention of such rules as the Commission may adopt to define, and prescribe means reasonably necessary to prevent, such acts, practices, or courses of business as are fraudulent, deceptive or manipulative.

`(2) CODES OF ETHICS- The rules adopted under paragraph (1) shall include requirements for the adoption of codes of ethics by a registered investment company and investment advisers of, and principal underwriters for, such investment companies establishing such standards as are reasonably necessary to prevent such acts, practices, or courses of business. Such rules and regulations shall require each such registered investment company to disclose such codes of ethics (and any changes therein) in the periodic report to shareholders of such company, and to disclose such code of ethics and any waivers and material violations thereof on a readily accessible electronic public information facility of such company and in such additional form and manner as the Commission shall require by rule or regulation.

`(3) ADDITIONAL COMPLIANCE PROCEDURES- The rules adopted under

paragraph (1) shall--

`(A) require each registered investment company and investment adviser to adopt and implement general policies and procedures reasonably designed to prevent violations of this title, the Securities Act of 1933 (15 U.S.C. 78a et seq.), the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.), the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7201 et seq.) and amendments made by that Act, the Trust Indenture Act of 1939 (15 U.S.C. 77aaa et seq.), the Investment Advisers Act of 1940 (15 U.S.C. 80b et seq.), the Securities Investor Protection Act of 1970 (15 U.S.C. 78aaa et seq.), subchapter II of chapter 53 of title 31, United States Code, chapter 2 of title I of Public Law 91-508 (12 U.S.C. 1951 et seq.), or section 21 of the Federal Deposit Insurance Act (12 U.S.C. 1829b);

`(B) require each registered investment company and registered investment adviser to review such policies and procedures annually for their adequacy and the effectiveness of their implementation; and

`(C) require each registered investment company to appoint a chief compliance officer to be responsible for overseeing such policies and procedures--

    `(i) whose compensation shall be approved by the members of the board of directors of the company who are not interested persons of the company;

    `(ii) who shall report directly to the members of the board of directors of the company who are not interested persons of such company, privately as such members request, but not less frequently than annually; and

    `(iii) whose report to such members shall include any violations or waivers of, and any other significant issues arising under, such policies and procedures.

`(4) CERTIFICATIONS- The rules adopted under paragraph (1) shall require each senior executive officer, or such officers designated by the Commission, of an investment adviser of a registered investment company to certify in each periodic report to shareholders, or other appropriate disclosure document, that--

    `(A) procedures are in place for verifying that the determination of current net asset value of any redeemable security issued by the company used in computing periodically the current price for the purpose of purchase, redemption, and sale complies with the requirements of this title and the rules and regulations issued under this title, and the company is in compliance with such procedures;

    `(B) procedures are in place to ensure that, if the shares of the company are

offered as different classes of shares, such classes are designed in the interests of shareholders, and could reasonably be an appropriate investment option for a shareholder;

`(C) procedures are in place to ensure that information about the portfolio securities of the company is not disclosed in violation of the securities laws or the code of ethics of the company;

`(D) the members of the board of directors who are not interested persons of the company have reviewed and approved the compensation of the portfolio manager of the company in connection with their consideration of the investment advisory contract under section 15(c); and

`(E) the company has established and enforces a code of ethics, as required by paragraph (2).'

(b) WHISTLEBLOWER PROTECTION- Section 1514A(a) of title 18, United States Code, is amended by striking the matter preceding paragraph (1) and inserting the following:

`(a) WHISTLEBLOWER PROTECTION FOR EMPLOYEES OF PUBLICLY TRADED COMPANIES AND REGISTERED INVESTMENT COMPANIES- No company with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l), or that is required to file reports under section 15(d) of the Securities and Exchange Act of 1934 (15 U.S.C. 78o(d)), or that is an investment adviser, principal underwriter, or significant service provider (as such terms are defined under section 2(a) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)) of an investment company which is registered under section 8 of the Investment Company Act of 1940, or any officer, employee, contractor, subcontractor, or agent of such company, may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment because of any lawful act done by the employee--'.

## **TITLE II--FUND TRANSPARENCY**

### **SEC. 210. COST CONSOLIDATION AND CLARITY.**

(a) EXPENSE RATIO COMPUTATION-

(1) IN GENERAL- The Commission shall, by rule, develop a standardized method of calculating the expense ratio of a registered investment company that accounts for as many operating costs to shareholders of such companies as is practicable.

(2) SEPARATE DISCLOSURES- In developing the method of calculation required under paragraph (1), if the Commission determines that the inclusion of certain costs in such calculation will lead to a significant risk of confusing or misleading shareholders, the Commission shall develop separate standardized methods for the calculation and disclosure of such costs.

(b) TRANSACTION COST RATIO- The Commission shall, by rule, develop a standardized method of computing the transaction cost ratio of a registered investment company that

practicably and fairly accounts for actual transaction costs to shareholders, including, at a minimum, brokerage commissions and bid-ask spread costs. Such computation, if necessary for ease of administration, may be based upon a fair method of estimation or a standardized derivation from easily ascertainable information.

(c) DISCLOSURE OF EXPENSE RATIO AND TRANSACTION COST RATIO- The Commission shall, by rule, require the prominent disclosure of the expense ratio and the transaction cost ratio of a registered company, both separately and as a total investment cost ratio, in--

- (1) each annual report of the registered investment company;
- (2) any prospectus of the registered investment company, as part of a fee table; and
- (3) such other filings with the Commission as the Commission determines appropriate.

(d) ACTUAL COST DISCLOSURE- The Commission shall, by rule, require, on at least an annual basis, the prominent disclosure in the shareholder account statement of a registered investment company of the actual dollar amount of the projected annual costs of each shareholder of the company, based upon the asset value of the shareholder at the time of the disclosure.

(e) DEFINITION OF FEES AND EXPENSES-

(1) IN GENERAL- The Commission shall, by rule, define all specific allowable types or categories of fees and expenses that may be borne by the shareholders of a registered investment company.

(2) NEW FEES AND EXPENSES- No new fee or expense, other than any defined under paragraph (1), shall be borne by the shareholders of a registered investment company, unless the Commission finds that such new fee or expense fairly reflects the services provided to, or is in the best interests of the shareholders of--

- (A) a particular registered investment company;
- (B) specific types or categories of registered investment companies; or
- (C) registered investment companies in general.

(f) COST STRUCTURES- The Commission shall promulgate such rules or regulations as are necessary--

- (1) to promote the standardization and simplification of the disclosure of the cost structures of registered investment companies; and
- (2) to ensure that the shareholders of such registered investment companies receive all material information regarding such costs--
  - (A) in a nonmisleading manner; and

(B) in such form and prominence as to facilitate, to the extent practicable, ease of comprehension and comparison of such costs.

(g) DESCRIPTIONS OF FEES, EXPENSES, AND COSTS- The Commission shall, by rule, require--

(1) the disclosure, in any annual or periodic report filed with the Commission or any prospectus delivered to the shareholders of a registered investment company, of all types of fees, expenses, or costs borne by shareholders;

(2) a clear definition of each such fee, expense, or cost; and

(3) information as to where shareholders may find out more information concerning such fees, expenses, or costs.

## **SEC. 211. ADVISOR COMPENSATION AND OWNERSHIP OF FUND SHARES.**

(a) COMPENSATION OF INVESTMENT ADVISER- The Commission shall, by rule, require--

(1) the disclosure to the shareholders of a registered investment company of--

(A) the amount and structure of, or the method used to determine, the compensation paid by the registered investment company to the portfolio manager or portfolio management team of the investment adviser; and

(B) the ownership interest in such company of the portfolio manager or portfolio management team; and

(2) the disclosure to the board of directors of the registered investment company of all transactions in the securities of the company by the portfolio manager or management team of the investment adviser of such company.

(b) FORM OF DISCLOSURE- The disclosures required under subparagraphs (A) and (B) of subsection (a)(1) shall be made by a registered investment company in--

(1) the registration statement of the company; and

(2) any other filings with the Commission that the Commission determines appropriate.

## **SEC. 212. POINT OF SALE AND ADDITIONAL DISCLOSURE OF BROKER COMPENSATION.**

Section 15(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(b)) is amended by adding at the end the following:

(11) BROKER DISCLOSURES IN MUTUAL FUND TRANSACTIONS-

`(A) IN GENERAL- Each broker shall disclose in writing to each person that purchases the shares of an investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8)--

`(i) the source and amount of any compensation received or to be received by the broker in connection with such transaction; and

`(ii) such other information as the Commission determines appropriate.

`(B) TIMING OF DISCLOSURE- The disclosures required under subparagraph (A) shall be made at or before the time of the purchase transaction.

`(C) LIMITATION- The disclosures required under subparagraph (A) may not be made exclusively in--

`(i) a registration statement or prospectus of the registered investment company; or

`(ii) any other filing of a registered investment company with the Commission.!

### **SEC. 213. BREAKPOINT DISCOUNTS.**

The Commission, by rule, shall require the disclosure by any registered investment company, in any quarterly or other periodic report filed with the Commission, information concerning discounts on front-end sales loads for

which shareholders may be eligible, including the minimum purchase amounts required for such discounts.

### **SEC. 214. PORTFOLIO TURNOVER RATIO.**

The Commission, by rule, shall require the disclosure, by any registered investment company, in any quarterly or periodic report filed with the Commission, and in any prospectus delivered to the shareholders of such company, of the portfolio turnover ratio of the company, and an explanation of its meaning and implications for cost and performance. Such rules shall require the disclosures to be prominently displayed within the appropriate document.

### **SEC. 215. PROXY VOTING POLICIES AND RECORD.**

Section 30 of the Investment Company Act of 1940 (15 U.S.C. 80a-29) is amended by adding at the end the following:

`(k) PROXY VOTING DISCLOSURE-

`(1) IN GENERAL- Each registered investment company, other than a small business investment company, shall file with the Commission, not later than August 31 of each

year, an annual report, on a form prescribed by the Commission by rule, containing the proxy voting record of the registrant and policies of the company with respect to the voting of such proxies for the most recent 12-month period ending on June 30.

`(2) NOTICE IN FINANCIAL STATEMENTS- The financial statements of each registered investment company shall state that information regarding how the company voted proxies and proxy voting policies relating to portfolio securities during the most recent 12-month period ending on June 30 is available--

`(A) without charge, upon request, by calling a specified toll-free (or collect) telephone number; or on or through the company's website at a specified Internet address, or both; and

`(B) on the website of the Commission.'.

## **SEC. 216. CUSTOMER INFORMATION FROM ACCOUNT INTERMEDIARIES.**

(a) IN GENERAL- The Commission shall, by rule, require that each account intermediary of a registered investment company provide to such company, with respect to each account serviced by the intermediary, such information as is necessary for the company to enforce its investment, trading, and fee policies.

(b) REQUIREMENTS- The information provided by a registered investment company under subsection (a) shall include, at a minimum--

(1) the name under which the account is opened with the intermediary;

(2) the taxpayer identification number of such person;

(3) the mailing address of such person; and

(4) individual transaction data for all purchases, redemptions, transfers, and exchanges by or on behalf of such person.

(c) PRIVACY OF INFORMATION- The information provided under subsection (a), and the use thereof, shall be subject to all Federal and State laws with regard to privacy and proprietary information.

## **SEC. 217. ADVERTISING.**

(a) PERFORMANCE ADVERTISING- The Commission shall promulgate such rules as the Commission determines necessary with respect to the advertising of a registered investment company regarding--

(1) unrepresentative short-term performance;

(2) performance based upon an undisclosed or improbable event; and

(3) performance based upon incomplete or misleading data.

(b) DOLLAR AND TIME-WEIGHTED RETURNS-

(1) IN GENERAL- Subject to paragraph (2), the Commission shall, by rule, require each registered investment company to disclose, in its annual report and any prospectus delivered to shareholders, dollar-weighted returns and time-weighted returns for each of--

- (A) the preceding fiscal year;
- (B) the preceding 5 fiscal years;
- (C) the preceding 10 fiscal years; and
- (D) the life of the company.

(2) EXCEPTION- The Commission may omit or require additional disclosures required under paragraph (1) for such time periods as the Commission determines necessary.

(3) COMMISSION USE OF BENCHMARKS- The Commission may require, in the interest of facilitating non-misleading disclosures, that any performance-related advertising by a registered investment company be accompanied by such benchmarks as the Commission may deem appropriate.

(c) SUBSIDIZED YIELDS- The Commission shall, by rule, require that any registered investment company that discloses in any publication a subsidized yield to disclose in the same publication the amount and duration of such subsidy.

**TITLE III--FUND REGULATION AND OVERSIGHT**

**SEC. 310. PROHIBITION OF ASSET-BASED DISTRIBUTION EXPENSES.**

(a) REPEAL OF RULE 12b-1-

(1) IN GENERAL- Beginning 180 days after the date of enactment of this Act (or such earlier time as the Commission may elect), as in effect on the date of enactment of this Act, section 270.12b-1 of chapter II of title 17 of the Code of Federal Regulations, promulgated under section 12 of the Investment Company Act of 1940 (15 U.S.C. 80a-12), is repealed, and shall have no force or effect.

(2) PRESERVATION OF ACTIONS- Paragraph (1) shall have no effect on any case pending or penalty imposed under section 270.12b-1 of the Code of Federal Regulations prior to the date of repeal under paragraph (1).

(b) PAYMENT OF DISTRIBUTION EXPENSES FROM MANAGEMENT FEE- Section 12 of the Investment Company Act of 1940 (15 U.S.C. 80a-12) is amended by adding at the end the following:

(h) PAYMENT OF DISTRIBUTION EXPENSES- Notwithstanding any provision of subsection (b), or any rule or regulation promulgated thereunder, distribution expenses

incurred by an investment adviser may be paid out of the management fee received by the investment adviser.'

(c) SUMS EXPENDED PROMOTING SALE OF SECURITIES- The Commission shall, by rule--

(1) require that any sums expended by the investment adviser of a registered investment company to promote or facilitate the sale of the securities of such company be disclosed to the board of directors of the company;

(2) require that such sums be accounted for and identified in the expense ratio of any such company; and

(3) authorize the board of directors of any such company to prohibit its investment adviser from using any compensation received from the company for distribution expenses that the board determines not to be in the best interest of the shareholders of the company.

(d) PROHIBITION OF ASSET-BASED FEES- Section 12 of the Investment Company Act of 1940 (15 U.S.C. 80a-12), as amended by subsection (a), is amended by adding at the end the following:

`(i) ASSET-BASED FEES-

`(1) IN GENERAL- It shall be unlawful for any registered investment company to pay asset-based fees to any broker or dealer in connection with the offer or sale of the securities of such investment company.

`(2) DEFINITION OF ASSET-BASED FEES- The Commission shall, by rule, define the term 'asset-based fees' for purposes of this subsection.'

## **SEC. 311. PROHIBITION ON REVENUE SHARING, DIRECTED BROKERAGE, AND SOFT DOLLAR ARRANGEMENTS.**

(a) IN GENERAL- The Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.) is amended by inserting after section 12 the following:

## **`SEC. 12A. PROHIBITION ON REVENUE SHARING, DIRECTED BROKERAGE, AND SOFT DOLLAR ARRANGEMENTS.**

`(a) REVENUE SHARING ARRANGEMENTS- It shall be unlawful for any investment adviser to enter into a revenue sharing arrangement with any broker or dealer with respect to the securities of a registered investment company.

`(b) DIRECTED BROKERAGE ARRANGEMENTS- It shall be unlawful for any registered investment company, or any affiliate of such company, to enter into a directed brokerage arrangement with a broker or dealer.

`(c) SOFT-DOLLAR ARRANGEMENTS- It shall be unlawful for any registered investment

company or registered investment adviser to enter into a soft-dollar arrangement with any broker or dealer.

`(d) Regulations Respecting Section 28(E) OF THE SECURITIES EXCHANGE ACT OF 1934- The Commission shall, by rule, narrow the soft-dollar safe harbor under section 28(e) of the Securities Exchange Act of 1934 (15 U.S.C. 78bb(e)(1)) to promote such parity as the Commission determines appropriate, and in the best interests of shareholders of a registered investment company, between registered investment companies governed by section 12A, and companies not covered by section 12A.

`(e) DEFINITIONS-

`(1) IN GENERAL- In this section--

`(A) the term `directed brokerage arrangement' means the direction of discretionary brokerage by an investment company or an affiliate of that company, to a broker or dealer in exchange for services other than trade executions;

`(B) the term `revenue sharing arrangement' means any direct or indirect payment made by an investment adviser (or any affiliate of an investment adviser) to a broker or dealer for the purpose of promoting the sales of securities of a registered investment company, other than any payment made directly by a shareholder as a commission for the purchase of such securities;

`(C) the term `soft-dollar arrangement' means payments to a broker or dealer for best trade executions in exchange for, or which generate credits for, services or products other than trade executions; and

`(D) the term `trade executions' has the meaning given that term by the Commission, by rule;

`(2) REGULATIONS- The Commission may, by rule, refine the definitions under paragraph (1), define such other terms as the Commission determines necessary, and otherwise tailor the proscriptions set forth under this section to achieve the purposes of--

`(A) protecting the best interests of shareholders of a registered investment company;

`(B) minimizing or eliminating conflicts with the best interests of shareholders of a registered investment company;

`(C) enhancing market negotiation for and price competition in trade execution services, and products and services previously obtained under arrangements prohibited by this section;

`(D) ensuring the transparency of transactions for trade executions, and products and services previously obtained under arrangements prohibited by

this section, and disclosure to shareholders of costs associated with trade executions, and products and services previously obtained under arrangements prohibited by this section, that is simplified, clear, and comprehensible; and

“(E) providing reasonable safe harbors for conduct otherwise consistent with such purposes.”.

(b) TECHNICAL AND CONFORMING AMENDMENT- Section 28(e)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78bb(e)(1)) is amended by striking “This section is exclusive” and inserting “Except as provided under section 12A of the Investment Company Act of 1940, this section is exclusive”.

### **SEC. 312. MARKET TIMING.**

(a) IN GENERAL- The Commission shall, by rule, require--

(1) the disclosure in any registration statement filed with the Commission by a registered investment company of the market timing policies of that company and the procedures adopted to enforce such policies; and

(2) that any registered investment company that declines to adopt restrictions on market timing disclose such fact in the registration statement of the company, and in any advertising or other publicly available documents, as the Commission determines necessary.

(b) FUNDAMENTAL INVESTMENT POLICY- The policies required to be disclosed under paragraph (1) shall be deemed “fundamental investment policies” for purposes of sections 8(b)(3) and 13(a)(3) of the Investment Company Act of 1940 (15 U.S.C. 80a-8(b)(3) and 80a-13(a)(3)).

### **SEC. 313. ELIMINATION OF STALE PRICES.**

(a) IN GENERAL- Not later than 90 days after the date of enactment of this Act, the Commission shall prescribe, by rule or regulation, standards concerning the obligation of registered investment companies under the Investment Company Act of 1940, to apply and use fair value methods of determination of net asset value when market quotations are unavailable or do not accurately reflect the fair market value of the portfolio securities of such a company, in order to prevent dilution of the interests of long-term shareholders or as necessary in the public interest or for the protection of shareholders.

(b) CONTENT- The rule or regulation prescribed under subsection (a) shall identify, in addition to significant events, the conditions or circumstances from which such an obligation will arise, such as the need to value securities traded on foreign exchanges, and the methods by which fair value methods shall be applied in such events, conditions, and circumstances.

## **SEC. 314. PROHIBITION OF SHORT TERM TRADING; MANDATORY REDEMPTION FEES.**

(a) SHORT-TERM TRADING PROHIBITED- Section 17 of the Investment Company Act of 1940 (15 U.S.C. 80a-17) is amended by adding at the end the following:

`(k) SHORT-TERM TRADING PROHIBITED-

`(1) PROHIBITION- It shall be unlawful for any officer, director, partner, or employee of a registered investment company, any affiliated person, investment adviser, or principal underwriter of such company, or any officer, director, partner, or employee of such an affiliated person, investment adviser, or principal underwriter, to engage in any short-term transaction, in any securities issued by such company, or any affiliate of such company.

`(2) LIMITATION- This subsection does not prohibit any transaction in a money market fund, or in funds, the investment policy of which expressly permits short-term transactions, or such other category of registered investment company as the Commission shall specify, by rule.

`(3) DEFINITION- For purposes of this subsection, the term 'short-term transaction' has the meaning given that term by the Commission, by rule.'

(b) MANDATORY REDEMPTION FEES- The Commission shall, by rule, require any registered investment company that does not allow for market timing practices to charge a redemption fee upon the short-term redemption of any securities of such company. In determining the application of mandatory redemption fees, shares shall be considered in the reverse order of their purchase.

(c) INCREASED REDEMPTION FEES PERMITTED FOR SHORT-TERM TRADING- Not later than 90 days after the date of enactment of this Act, the Commission shall permit a registered investment company to charge redemption fees in excess of 2 percent upon the redemption of any securities of such company that are redeemed within such period after their purchase as the Commission specifies in such rule to deter short term trading that is unfair to the shareholders of such company.

(d) DEADLINE FOR RULES- The Commission shall prescribe rules to implement section 17(k) of the Investment Company Act of 1940, as added by subsection (a) of this section, not later than 90 days after the date of enactment of this Act.

## **SEC. 315. PREVENTION OF AFTER-HOURS TRADING.**

(a) ADDITIONAL RULES REQUIRED- The Commission shall issue rules to prevent transactions in the securities of any registered investment company in violation of section 22 of the Investment Company Act of 1940 (15 U.S.C. 80a-22), including after-hours trades that are executed at a price based on a net asset value that was determined as of a time prior to the actual execution of the transaction.

(b) TRADES COLLECTED BY INTERMEDIARIES- The Commission shall determine the circumstances under which to permit, subject to rules of the Commission and an annual independent audit of such trades, the execution of after-hours trades that are provided to a registered investment company by a broker, dealer, retirement plan administrator, insurance company, or other intermediary, after the time as of which the net asset value was determined.

## **SEC. 316. BAN ON JOINT MANAGEMENT OF MUTUAL FUNDS AND HEDGE FUNDS.**

(a) AMENDMENT- Section 15 of the Investment Company Act of 1940 (15 U.S.C. 80a-15) is amended by adding at the end the following:

(h) BAN ON JOINT MANAGEMENT OF MUTUAL FUNDS AND HEDGE FUNDS-

(1) PROHIBITION OF JOINT MANAGEMENT- It shall be unlawful for any individual to serve or act as the portfolio manager or investment adviser of a registered open-end investment company if such individual also serves or acts as the portfolio manager or investment adviser of an investment company that is not registered or of such other categories of companies as the Commission shall prescribe by rule in order to prohibit conflicts of interest, such as conflicts in the selection of the portfolio securities.

(2) EXCEPTIONS- Notwithstanding paragraph (1), the Commission may, by rule, regulation, or order, permit joint management by a portfolio manager in exceptional circumstances when necessary to protect the interest of shareholders, provided that such rule, regulation, or order requires--

(A) enhanced disclosure by the registered open-end investment company to shareholders of any conflicts of interest raised by such joint management; and

(B) fair and equitable policies and procedures for the allocation of securities to the portfolios of the jointly managed companies, and certification by the members of the board of directors who are not interested persons of such registered open-end investment company, in the periodic report to shareholders, or other appropriate disclosure document, that such policies and procedures of such company are fair and equitable.

(3) DEFINITION- For purposes of this subsection, the term 'portfolio manager' means the individual or individuals who are designated as responsible for decision-making in connection with the securities purchased and sold on behalf of a registered open-end investment company, but shall not include individuals who participate only in making research recommendations or executing transactions on behalf of such company.

(b) DEADLINE FOR RULES- The Commission shall prescribe rules to implement section 15(h) of the Investment Company Act of 1940, as added by subsection (a) of this section, not later than 90 days after the date of enactment of this Act.

## **SEC. 317. SELECTIVE DISCLOSURES.**

(a) IN GENERAL- The Commission shall promulgate such rules as the Commission determines necessary to prevent the selective disclosure by a registered investment company of material information relating to the portfolio of securities held by such company.

(b) REQUIREMENTS- The rules promulgated under subsection (a) shall treat selective disclosures of material information by a registered investment company in substantially the same manner as selective disclosures by issuers of securities registered under section 12 of the Securities Exchange Act of 1934 under the rules of the Commission.

### **TITLE IV--STUDIES**

## **SEC. 410. STUDY OF ADVISER CONFLICT OF INTEREST.**

(a) IN GENERAL- The Commission shall conduct a study of--

(1) the consequences of the inherent conflicts of interest confronting investment advisers employed by registered investment companies;

(2) the extent to which legislative or regulatory measures could minimize such conflicts of interest; and

(3) the extent to which legislative or regulatory measures could incentivize internal management of a registered investment company.

(b) REPORT- Not later than 1 year after the date of enactment of this Act, the Commission shall submit a report on the results of the study required under subsection (a) to--

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

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

## **SEC. 411. STUDY OF COORDINATION OF ENFORCEMENT EFFORTS.**

(a) IN GENERAL- The Comptroller General of the United States, with the cooperation of the Commission, shall conduct a study of the coordination of enforcement efforts between--

(1) the headquarters of the Commission;

(2) the regional offices of the Commission; and

(3) State regulatory and law enforcement agencies.

(b) REPORT- Not later than 1 year after the date of enactment of this Act, the Commission shall submit a report on the results of the study required under subsection (a) to--

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

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

## **SEC. 412. STUDY OF COMMISSION ORGANIZATIONAL STRUCTURE.**

(a) IN GENERAL- The Comptroller General of the United States, with the cooperation of the Commission, shall conduct a study of--

- (1) the current organizational structure of the Commission with respect to the regulation of investment companies;
- (2) whether the organizational structure and resources of the Commission sufficiently credit the importance of oversight of investment companies to the 95 million investors in such companies within the United States;
- (3) whether certain organizational features of that structure, such as the separation of regulatory and enforcement functions, are sufficient to promote the optimal understanding of the current practices of investment companies; and
- (4) whether a separate regulatory entity would improve or impair effective oversight.

(b) REPORT- Not later than 1 year after the date of enactment of this Act, the Comptroller General shall submit a report on the results of the study required under subsection (a) to--

- (1) the Committee on Banking, Housing, and Urban Affairs of the Senate; and
- (2) the Committee on Financial Services of the House of Representatives.

## **SEC. 413. TRENDS IN ARBITRATION CLAUSES.**

(a) IN GENERAL- The Commission shall conduct a study on the trends in arbitration clauses between brokers, dealers, and investors since December 31, 1995, and alternative means to avert the filing of claims in Federal or State courts.

(b) REPORT- Not later than 1 year after the date of enactment of this Act, the Commission shall submit a report on the results of the study required under subsection (a) to--

- (1) the Committee on Banking, Housing, and Urban Affairs of the Senate; and
- (2) the Committee on Financial Services of the House of Representatives.

## **SEC. 414. HEDGE FUND REGULATION.**

(a) IN GENERAL- The Commission shall conduct a study of whether additional regulation of alternative investment vehicles, such as hedge funds, is appropriate to deter the recurrence of trading abuses, manipulation of registered investment companies by unregistered investment companies, or other distortions that may harm investors in registered investment companies.

(b) REPORT- Not later than 1 year after the date of enactment of this Act, the Commission shall submit a report on the results of the study required under subsection (a) to--

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

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

## **SEC. 415. INVESTOR EDUCATION AND THE INTERNET.**

(a) IN GENERAL- The Commission shall conduct a study of--

(1) the means of enhancing the role of the Internet in educating investors and providing timely information regarding laws, regulations, enforcement proceedings, and individual registered investment companies;

(2) the feasibility of mandating that each registered investment company maintain a website on which shall be posted filings of the registered investment company with the Commission and any other material information related to the registered investment company; and

(3) the means of ensuring that the EDGAR database maintained by the Commission is user-friendly and contains a search engine that facilitates the expeditious location of material information.

(b) REPORT- Not later than 1 year after the date of enactment of this Act, the Commission shall submit a report on the results of the study required under subsection (a) to--

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

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