

# Union Calendar No. 205

108TH CONGRESS  
1ST SESSION

# H. R. 2420

[Report No. 108-351]

To improve transparency relating to the fees and costs that mutual fund investors incur and to improve corporate governance of mutual funds.

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## IN THE HOUSE OF REPRESENTATIVES

JUNE 11, 2003

Mr. BAKER (for himself, Mr. GILLMOR, Mr. OSE, Mr. SHAYS, Mr. TIBERI, and Ms. GINNY BROWN-WAITE of Florida) introduced the following bill; which was referred to the Committee on Financial Services

NOVEMBER 4, 2003

Additional sponsors: Mr. OXLEY, Mr. FRANK of Massachusetts, Mr. CASTLE, Ms. WATERS, Mrs. MALONEY, Ms. HOOLEY of Oregon, Mr. MOORE, Mr. FORD, Mr. JONES of North Carolina, Mr. GONZALEZ, Mr. EMANUEL, Mr. MATHESON, Mr. SCOTT of Georgia, Mr. HINOJOSA, Mr. HENSARLING, Mrs. CAPITO, Mr. GARRETT of New Jersey, and Mrs. BIGGERT

NOVEMBER 4, 2003

Reported with an amendment, committed to the Committee of the Whole House on the State of the Union, and ordered to be printed

[Strike out all after the enacting clause and insert the part printed in *italic*]

[For text of introduced bill, see copy of bill as introduced on June 11, 2003]

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## A BILL

To improve transparency relating to the fees and costs that mutual fund investors incur and to improve corporate governance of mutual funds.

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

3 **SECTION 1. SHORT TITLE.**

4        *This Act may be cited as the “Mutual Funds Integrity*  
5 *and Fee Transparency Act of 2003”.*

6 **SEC. 2. IMPROVED TRANSPARENCY OF MUTUAL FUND**  
7                    **COSTS.**

8        *(a) REGULATION REVISION REQUIRED.—Within 270*  
9 *days after the date of enactment of this Act, the Securities*  
10 *and Exchange Commission shall revise regulations under*  
11 *the Securities Act of 1933, the Securities Exchange Act of*  
12 *1934, or the Investment Company Act of 1940, or any com-*  
13 *bination thereof, to require, consistent with the protection*  
14 *of investors and the public interest, improved disclosure*  
15 *with respect to an open-end management investment com-*  
16 *pany, in the quarterly statement or other periodic report*  
17 *to shareholders or other appropriate disclosure document,*  
18 *of the following:*

19            *(1) The estimated amount, in dollars for each*  
20            *\$1,000 of investment in the company, of the operating*  
21            *expenses of the company that are borne by share-*  
22            *holders.*

23            *(2) The structure of, or method used to deter-*  
24            *mine, the compensation of individuals employed by*  
25            *the investment adviser of the company to manage the*

1        *portfolio of the company, and the ownership interest*  
2        *of such individuals in the securities of the company.*

3            *(3) The portfolio turnover rate of the company,*  
4        *set forth in a manner that facilitates comparison*  
5        *among investment companies, and a description of*  
6        *the implications of a high turnover rate for portfolio*  
7        *transaction costs and performance.*

8            *(4) Information concerning the company's poli-*  
9        *cies and practices with respect to the payment of com-*  
10       *missions for effecting securities transactions to a*  
11       *member of an exchange, broker, or dealer who—*

12            *(A) furnishes advice, either directly or*  
13        *through publications or writings, as to the value*  
14        *of securities, the advisability of investing in,*  
15        *purchasing, or selling securities, and the avail-*  
16        *ability of securities or purchasers or sellers of se-*  
17        *curities;*

18            *(B) furnishes analyses and reports con-*  
19        *cerning issuers, industries, securities, economic*  
20        *factors and trends, portfolio strategy, and the*  
21        *performance of accounts; or*

22            *(C) facilitates the sale and distribution of*  
23        *the company's shares.*

24            *(5) Information concerning payments by any*  
25        *person other than the company that are intended to*

1 *facilitate the sale and distribution of the company's*  
2 *shares.*

3 *(6) Information concerning discounts on front-*  
4 *end sales loads for which investors may be eligible, in-*  
5 *cluding the minimum purchase amounts required for*  
6 *such discounts.*

7 *(b) APPROPRIATE DISCLOSURE DOCUMENT.—*

8 *(1) IN GENERAL.—For purposes of subsection*  
9 *(a), a disclosure shall not be considered to be made*  
10 *in an appropriate disclosure document if the disclo-*  
11 *sure is made exclusively in a prospectus or statement*  
12 *of additional information, or both such documents.*

13 *(2) EXCEPTIONS.—Notwithstanding paragraph*  
14 *(1), the disclosures required by paragraph (2) and (4)*  
15 *of subsection (a) may be considered to be made in an*  
16 *appropriate disclosure document if the disclosure is*  
17 *made exclusively in a prospectus or statement of ad-*  
18 *ditional information, or both such documents.*

19 *(c) CONCEPT RELEASE REQUIRED.—*

20 *(1) IN GENERAL.—The Commission shall issue a*  
21 *concept release examining the issue of portfolio trans-*  
22 *action costs incurred by investment companies, in-*  
23 *cluding commission, spread, opportunity, and market*  
24 *impact costs, with respect to trading of portfolio secu-*  
25 *rities and how such costs may be disclosed to mutual*

1 *fund investors in a manner that will enable investors*  
2 *to compare such costs among funds.*

3 (2) *REPORT AND RECOMMENDATIONS RE-*  
4 *QUIRED.—The Commission shall submit a report on*  
5 *the findings from the concept release required by*  
6 *paragraph (1), as well as legislative and regulatory*  
7 *recommendations, if any, to the Committee on Finan-*  
8 *cial Services of the House of Representatives and the*  
9 *Committee on Banking, Housing, and Urban Affairs*  
10 *of the Senate, no later than 270 days after the date*  
11 *of enactment of this Act.*

12 (d) *ADDITIONAL REQUIREMENT FOR FEE STATE-*  
13 *MENT.—*

14 (1) *IN GENERAL.—Not later than 270 days after*  
15 *the date of enactment of this Act, the Commission*  
16 *shall prescribe a rule to require, with respect to an*  
17 *open-end management investment company, in the*  
18 *quarterly statement or other periodic report, or other*  
19 *appropriate disclosure document, a statement inform-*  
20 *ing shareholders that such shareholders have paid fees*  
21 *on their investments, that such fees have been de-*  
22 *ducted from the amounts shown on the statements,*  
23 *and where such shareholders may find additional in-*  
24 *formation regarding the amount of these fees.*

1           (2) *APPROPRIATE DISCLOSURE DOCUMENT.*—The  
2           statement required by paragraph (1) shall not be con-  
3           sidered to be made in an appropriate disclosure docu-  
4           ment unless such statement is—

5                   (A) made in each periodic statement to a  
6                   shareholder that discloses the value of the hold-  
7                   ings of the shareholder in the securities of the  
8                   company; and

9                   (B) prominently displayed, in a location in  
10                  close proximity to the statement of the shares ac-  
11                  count value.

12          (e) *REDUCING BURDENS ON SMALL FUNDS.*—In pre-  
13          scribing rules under this section, the Commission shall give  
14          consideration to methods for reducing for small investment  
15          companies the burdens of making the disclosures required  
16          by such rules, consistent with the public interest and the  
17          protection of investors.

18          **SEC. 3. OBLIGATIONS REGARDING CERTAIN DISTRIBUTION**

19                                   **AND SOFT DOLLAR ARRANGEMENTS.**

20          (a) *REPORTING REQUIREMENT.*—Section 15 of the In-  
21          vestment Company Act of 1940 (15 U.S.C. 80a-15) is  
22          amended by adding at the end the following new subsection:

23                   “(g) *OBLIGATIONS REGARDING CERTAIN DISTRIBUTION AND SOFT DOLLAR ARRANGEMENTS.*—  
24

1           “(1) *REPORTING REQUIREMENTS.*—*Each invest-*  
2           *ment adviser to a registered investment company*  
3           *shall, no less frequently than annually, submit to the*  
4           *board of directors of the company a report on—*

5                     “(A) *payments during the reporting period*  
6                     *by the adviser (or an affiliated person of the ad-*  
7                     *viser) that were directly or indirectly made for*  
8                     *the purpose of promoting the sale of shares of the*  
9                     *investment company (referred to in paragraph*  
10                    *(2) as a ‘revenue sharing arrangement’);*

11                    “(B) *services to the company provided or*  
12                    *paid for by a broker or dealer or an affiliated*  
13                    *person of the broker or dealer (other than broker-*  
14                    *age and research services) in exchange for the di-*  
15                    *rection of brokerage to the broker or dealer (re-*  
16                    *ferred to in paragraph (2) as a ‘directed broker-*  
17                    *age arrangement’); and*

18                    “(C) *research services obtained by the ad-*  
19                    *viser (or an affiliated person of the adviser) dur-*  
20                    *ing the reporting period from a broker or dealer*  
21                    *the receipt of which may reasonably be attrib-*  
22                    *uted to securities transactions effected on behalf*  
23                    *of the company or any other company that is a*  
24                    *member of the same group of investment compa-*

1           nies (referred to in paragraph (2) as a ‘soft dol-  
2           lar arrangement’).

3           “(2) *FIDUCIARY DUTY OF BOARD OF DIREC-*  
4           *TORS.—The board of directors of a registered invest-*  
5           *ment company shall have a fiduciary duty—*

6                   “(A) *to review the investment adviser’s di-*  
7                   *rection of the company’s brokerage transactions,*  
8                   *including directed brokerage arrangements and*  
9                   *soft dollar arrangements, and to determine that*  
10                  *the direction of such brokerage is in the best in-*  
11                  *terests of the shareholders of the company; and*

12                   “(B) *to review any revenue sharing ar-*  
13                   *rangements to ensure compliance with this Act*  
14                   *and the rules adopted thereunder, and to deter-*  
15                   *mine that such revenue sharing arrangements*  
16                   *are in the best interests of the shareholders of the*  
17                   *company.*

18           “(3) *SUMMARIES OF REPORTS IN ANNUAL RE-*  
19           *PORTS TO SHAREHOLDERS.—In accordance with reg-*  
20           *ulations prescribed by the Commission under para-*  
21           *graph (4), annual reports to shareholders of a reg-*  
22           *istered investment company shall include a summary*  
23           *of the most recent report submitted to the board of di-*  
24           *rectors under paragraph (1).*

1           “(4) *REGULATIONS.*—*The Commission shall*  
2 *adopt rules and regulations implementing this sec-*  
3 *tion, which rules and regulations shall, among other*  
4 *things, prescribe the content of the required reports.*

5           “(5) *DEFINITION.*—*For purposes of this sub-*  
6 *section—*

7                   “(A) *the term ‘brokerage and research serv-*  
8 *ices’ has the same meaning as in section 28(e)(3)*  
9 *of the Securities Exchange Act of 1934; and*

10                   “(B) *the term ‘research services’ means the*  
11 *services described in subparagraphs (A) and (B)*  
12 *of such section.”.*

13           “(b) *CONTRACTUAL RECORDS.*—*Within 270 days after*  
14 *the date of enactment of this Act, the Securities and Ex-*  
15 *change Commission shall, by rule prescribed pursuant to*  
16 *section 28(e) of the Securities Exchange Act of 1934 (15*  
17 *U.S.C. 78bb(e)), require that—*

18                   “(1) *if any research services (as such term is de-*  
19 *finied in section 15(g)(5)(B) of the Investment Com-*  
20 *pany Act of 1940, as amended by subsection (a) of*  
21 *this section)—*

22                           “(A) *are provided by a member of an ex-*  
23 *change, broker, or dealer who effects securities*  
24 *transactions in an account, and*

1           (B) are prepared or provided by a party  
 2           that is unaffiliated with such member, broker, or  
 3           dealer,  
 4           any person exercising investment discretion with re-  
 5           spect to such account shall maintain a copy of the  
 6           written contract between the person preparing such  
 7           research and the member of an exchange, broker, or  
 8           dealer; and

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

11 **SEC. 4. MUTUAL FUND GOVERNANCE.**

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

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

19           (1) in subparagraph (A)—

20               (A) by striking clause (vi) and redesi-  
 21 gnating clause (vii) as clause (vi); and

22               (B) by amending clause (v) to read as fol-  
 23 lows:

24                       “(v) any natural person who is a  
 25                       member of a class of persons who the Com-

1 mission, by rule or regulation, determines  
2 are unlikely to exercise an appropriate de-  
3 gree of independence as a result of—

4 “(I) a material business or profes-  
5 sional relationship with the company  
6 or any affiliated person of the com-  
7 pany, or

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

11 (2) in subparagraph (B)—

12 (A) by striking clause (vi) and redesign-  
13 ating clause (vii) as clause (vi); and

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

16 “(v) any natural person who is a  
17 member of a class of persons who the Com-  
18 mission, by rule or regulation, determines  
19 are unlikely to exercise an appropriate de-  
20 gree of independence as a result of—

21 “(I) a material business or profes-  
22 sional relationship with such invest-  
23 ment adviser or principal underwriter  
24 (or affiliated person thereof), or

1                   “(II) a close familial relationship  
2                   with a natural person who is such in-  
3                   vestment adviser or principal under-  
4                   writer (or affiliated person thereof),”.

5 **SEC. 5. AUDIT COMMITTEE REQUIREMENTS FOR INVEST-**  
6 **MENT COMPANIES.**

7           (a) *AMENDMENTS.*—Section 32 of the Investment Com-  
8 *pany Act of 1940 (15 U.S.C. 80a–31) is amended—*

9                   (1) *in subsection (a)—*

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

12                                   “(1) *such accountant shall have been selected at*  
13 *a meeting held within 30 days before or after the be-*  
14 *ginning of the fiscal year or before the annual meet-*  
15 *ing of stockholders in that year by the vote, cast in*  
16 *person, of a majority of the members of the audit*  
17 *committee of such registered company;*

18                                   “(2) *such selection shall have been submitted for*  
19 *ratification or rejection at the next succeeding annual*  
20 *meeting of stockholders if such meeting be held, except*  
21 *that any vacancy occurring between annual meetings,*  
22 *due to the death or resignation of the accountant,*  
23 *may be filled by the vote of a majority of the members*  
24 *of the audit committee of such registered company,*

1 *cast in person at a meeting called for the purpose of*  
2 *voting on such action;”;* and

3 *(B) by adding at the end the following new*  
4 *sentence: “The Commission, by rule, regulation,*  
5 *or order, may exempt a registered management*  
6 *company or registered face-amount certificate*  
7 *company subject to this subsection from the re-*  
8 *quirement in paragraph (1) that the votes by the*  
9 *members of the audit committee be cast at a*  
10 *meeting in person when such a requirement is*  
11 *impracticable, subject to such conditions as the*  
12 *Commission may require.”;* and

13 *(2) by adding at the end the following new sub-*  
14 *section:*

15 *“(d) AUDIT COMMITTEE REQUIREMENTS.—*

16 *“(1) REQUIREMENTS AS PREREQUISITE TO FIL-*  
17 *ING FINANCIAL STATEMENTS.—Any registered man-*  
18 *agement company or registered face-amount certifi-*  
19 *cate company that files with the Commission any fi-*  
20 *nancial statement signed or certified by an inde-*  
21 *pendent public accountant shall comply with the re-*  
22 *quirements of paragraphs (2) through (6) of this sub-*  
23 *section and any rule or regulation of the Commission*  
24 *issued thereunder.*

1           “(2) *RESPONSIBILITY RELATING TO INDE-*  
2 *PENDENT PUBLIC ACCOUNTANTS.—The audit com-*  
3 *mittee of the registered company, in its capacity as*  
4 *a committee of the board of directors, shall be directly*  
5 *responsible for the appointment, compensation, and*  
6 *oversight of the work of any independent public ac-*  
7 *countant employed by such registered company (in-*  
8 *cluding resolution of disagreements between manage-*  
9 *ment and the auditor regarding financial reporting)*  
10 *for the purpose of preparing or issuing the audit re-*  
11 *port or related work, and each such independent pub-*  
12 *lic accountant shall report directly to the audit com-*  
13 *mittee.*

14           “(3) *INDEPENDENCE.—*

15           “(A) *IN GENERAL.—Each member of the*  
16 *audit committee of the registered company shall*  
17 *be a member of the board of directors of the com-*  
18 *pany, and shall otherwise be independent.*

19           “(B) *CRITERIA.—In order to be considered*  
20 *to be independent for purposes of this paragraph,*  
21 *a member of an audit committee of a registered*  
22 *company may not, other than in his or her ca-*  
23 *capacity as a member of the audit committee, the*  
24 *board of directors, or any other board com-*  
25 *mittee—*

1           “(i) accept any consulting, advisory, or  
2           other compensatory fee from the registered  
3           company or the investment adviser or prin-  
4           cipal underwriter of the registered com-  
5           pany; or

6           “(ii) be an ‘interested person’ of the  
7           registered company, as such term is defined  
8           in section 2(a)(19).

9           “(4) COMPLAINTS.—The audit committee of the  
10          registered company shall establish procedures for—

11           “(A) the receipt, retention, and treatment of  
12          complaints received by the registered company  
13          regarding accounting, internal accounting con-  
14          trols, or auditing matters; and

15           “(B) the confidential, anonymous submis-  
16          sion by employees of the registered company and  
17          its investment adviser or principal underwriter  
18          of concerns regarding questionable accounting or  
19          auditing matters.

20           “(5) AUTHORITY TO ENGAGE ADVISERS.—The  
21          audit committee of the registered company shall have  
22          the authority to engage independent counsel and other  
23          advisers, as it determines necessary to carry out its  
24          duties.

1           “(6) *FUNDING.*—*The registered company shall*  
2           *provide appropriate funding, as determined by the*  
3           *audit committee, in its capacity as a committee of the*  
4           *board of directors, for payment of compensation—*

5                     “(A) *to the independent public accountant*  
6                     *employed by the registered company for the pur-*  
7                     *pose of rendering or issuing the audit report;*  
8                     *and*

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

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

13                    “(A) *a committee (or equivalent body) es-*  
14                    *tablished by and amongst the board of directors*  
15                    *of a registered investment company for the pur-*  
16                    *pose of overseeing the accounting and financial*  
17                    *reporting processes of the company and audits of*  
18                    *the financial statements of the company; and*

19                    “(B) *if no such committee exists with re-*  
20                    *spect to a registered investment company, the en-*  
21                    *tire board of directors of the company.”.*

22           (b) *CONFORMING AMENDMENT.*—*Section 10A(m) of*  
23           *the Securities Exchange Act of 1934 is amended by adding*  
24           *at the end the following new paragraph:*

1           “(7) *EXEMPTION FOR INVESTMENT COMPANIES.*—Effective one year after the date of enactment  
2           of the *Mutual Funds Integrity and Fee Transparency*  
3           *Act of 2003*, for purposes of this subsection, the term  
4           ‘*issuer*’ shall not include any investment company  
5           that is registered under section 8 of the *Investment*  
6           *Company Act of 1940*.”.

8           (c) *IMPLEMENTATION.*—Not later than 180 days after  
9           the date of enactment of this Act, the *Securities and Ex-*  
10          *change Commission* shall issue final regulations to carry  
11          out section 32(d) of the *Investment Company Act of 1940*,  
12          as added by subsection (a) of this section.

13 **SEC. 6. TRADING RESTRICTIONS.**

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

17          “(e) *TRADING RESTRICTIONS.*—

18                  “(1) *PROHIBITION AND EXCEPTIONS.*—No reg-  
19                  istered investment company shall suspend the right of  
20                  redemption, or postpone the date of payment or satis-  
21                  faction upon redemption of any redeemable security  
22                  in accordance with its terms for more than seven days  
23                  after the tender of such security to the company or its  
24                  agents designated for that purpose for redemption, ex-  
25                  cept—

1           “(A) for any period (i) during which the  
2           principal market for the securities in which the  
3           company invests is closed, other than customary  
4           week-end and holiday closings; or (ii) during  
5           which trading on such exchange is restricted;

6           “(B) for any period during which an emer-  
7           gency exists as a result of which (i) disposal by  
8           the company of securities owned by it is not rea-  
9           sonably practicable; or (ii) it is not reasonably  
10          practicable for such company fairly to determine  
11          the value of its net assets; or

12          “(C) for such other periods as the Commis-  
13          sion may by order permit for the protection of  
14          security holders of the company.

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

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

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

21                 “(C) provide for the determination by each  
22                 company, subject to such limitations as the Com-  
23                 mission shall determine are necessary and ap-  
24                 propriate for the protection of investors, of the

1           *principal market for the securities in which the*  
2           *company invests.”.*

3 **SEC. 7. DEFINITION OF NO-LOAD MUTUAL FUND.**

4           *Within 270 days after the date of enactment of this*  
5 *Act, the Securities and Exchange Commission shall, by rule*  
6 *adopted by the Commission or a self-regulatory organiza-*  
7 *tion (or both)—*

8           (1) *clarify the definition of “no-load” as such*  
9 *term is used by investment companies that impose*  
10 *any fee under a plan adopted pursuant to rule 12b-*  
11 *1 of the Commission’s rules (17 C.F.R. 270.12b-1);*  
12 *and*

13           (2) *require disclosure to prevent investors from*  
14 *being misled by the use of such terminology by the*  
15 *company or its adviser or principal underwriter.*

16 **SEC. 8. INFORMING DIRECTORS OF SIGNIFICANT DEFICIENCIES.**  
17

18           *Section 42 of the Investment Company Act of 1940 (15*  
19 *U.S.C. 80a-41) is amended by adding at the end the fol-*  
20 *lowing new subsection:*

21           “(f) **INFORMING DIRECTORS OF SIGNIFICANT DEFICIENCIES.**—*If the report of an inspection by the Commis-*  
22 *sion of a registered investment company identifies signifi-*  
23 *cant deficiencies in the operations of such company, or of*  
24 *its investment adviser or principal underwriter, the com-*  
25 *pany shall*

1 *pany shall provide such report to the directors of such com-*  
2 *pany.”.*

3 **SEC. 9. EXEMPTION FROM IN PERSON MEETING REQUIRE-**  
4 **MENTS.**

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

13 **SEC. 10. PROXY VOTING DISCLOSURE.**

14 *Section 30 of the Investment Company Act of 1940 (15*  
15 *U.S.C. 80a–29) is amended by adding at the end the fol-*  
16 *lowing new subsection:*

17 *“(k) PROXY VOTING DISCLOSURE.—Every registered*  
18 *management investment company, other than a small busi-*  
19 *ness investment company, shall file with the Commission*  
20 *not later than August 31 of each year an annual report,*  
21 *on a form prescribed by the Commission by rule, containing*  
22 *the registrant’s proxy voting record for the most recent*  
23 *twelve-month period ending on June 30. The financial*  
24 *statements of every such company shall state that informa-*  
25 *tion regarding how the company voted proxies relating to*

1 *portfolio securities during the most recent 12-month period*  
2 *ending on June 30 is available—*

3 *“(1) without charge, upon request, by calling a*  
4 *specified toll-free (or collect) telephone number; or on*  
5 *or through the company’s website at a specified Inter-*  
6 *net address; or both; and*

7 *“(2) on the Commission’s website.”.*

8 **SEC. 11. ETHICS COMPLIANCE BY MUTUAL FUNDS.**

9 *Within 270 days after the date of enactment of this*  
10 *Act, the Commission shall, by rule pursuant to the Invest-*  
11 *ment Company Act of 1940 and the Investment Advisers*  
12 *Act of 1940, require each investment company and invest-*  
13 *ment adviser registered with the Commission—*

14 *(1) to adopt and implement policies and proce-*  
15 *dures reasonably designed to prevent violation of the*  
16 *Securities Act of 1933 (15 U.S.C. 78a et seq.), the Se-*  
17 *curities Exchange Act of 1934 (15 U.S.C. 78a et seq.),*  
18 *the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7201 et*  
19 *seq.), the Trust Indenture Act of 1939 (15 U.S.C.*  
20 *77aaa et seq.), the Investment Company Act of 1940*  
21 *(15 U.S.C. 80a–1 et seq.), the Investment Advisers Act*  
22 *of 1940 (15 U.S.C. 80b et seq.), the Securities Investor*  
23 *Protection Act of 1970 (15 U.S.C. 78aaa et seq.), sub-*  
24 *chapter II of chapter 53 of title 31, United States*  
25 *Code, chapter 2 of title I of Public Law 91–508 (12*

1       *U.S.C. 1951 et seq.*), or section 21 of the *Federal De-*  
2       *posit Insurance Act (12 U.S.C. 1829b)*;

3             (2) *review those policies and procedures annu-*  
4       *ally for their adequacy and the effectiveness of their*  
5       *implementation; and*

6             (3) *appoint a chief compliance officer to be re-*  
7       *sponsible for administering the policies and proce-*  
8       *dures.*

9       **SEC. 12. INCENTIVE COMPENSATION AND MUTUAL FUND**

10                   **SALES.**

11             (a) *COMMISSION RULE REQUIRED.*—*Within 270 days*  
12       *after the date of enactment of this Act, the Commission shall*  
13       *by rule prohibit, as a means reasonably designed to prevent*  
14       *fraudulent, deceptive, or manipulative acts and practices,*  
15       *the sale of the securities of an investment company or of*  
16       *municipal fund securities by a broker or dealer or by a mu-*  
17       *nicipal securities broker or dealer without the disclosure*  
18       *of—*

19             (1) *the amount and source of sales fees, pay-*  
20       *ments by persons other than the investment company*  
21       *that are intended to facilitate the sale and distribu-*  
22       *tion of the securities, and commissions for effecting*  
23       *portfolio securities transactions, or other payments,*  
24       *paid to such broker or dealer, or municipal securities*

1 *broker or dealer, or associated person thereof in con-*  
2 *nection with such sale;*

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

6 *(3) any conflicts of interest that any associated*  
7 *person of the investor's broker or dealer or municipal*  
8 *securities broker or dealer may face due to the receipt*  
9 *of differential compensation in connection with such*  
10 *sale; and*

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

15 *(b) BENCHMARKS.—In connection with the rule re-*  
16 *quired by subsection (a), the Commission shall, to the extent*  
17 *practical, establish standards for such disclosures.*

18 *(c) DEFINITIONS.—*

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

24 *(A) for sales of the securities of an invest-*  
25 *ment company or municipal fund security that*

1            *is affiliated with, or otherwise specifically des-*  
2            *ignated by, such broker or dealer or municipal*  
3            *securities broker or dealer, as compared with the*  
4            *remuneration for sales of securities of an invest-*  
5            *ment company or municipal fund security of-*  
6            *ferred by such broker or dealer or municipal secu-*  
7            *rities broker or dealer that are not so affiliated*  
8            *or designated; or*

9            *(B) for the sale of any class of securities of*  
10           *an investment company or municipal fund secu-*  
11           *urity as compared with the remuneration for the*  
12           *sale of a class of securities of such investment*  
13           *company or municipal fund security (offered by*  
14           *such broker or dealer or municipal securities*  
15           *broker or dealer) that charges a sales load (as de-*  
16           *finied in section 2(a)(35) of the Investment Com-*  
17           *pany Act of 1940 (15 U.S.C. 80a-2(a)(35)) only*  
18           *at the time of such a sale.*

19           *(2) MUNICIPAL FUND SECURITY.—For purposes*  
20           *of this section, a municipal fund security is any mu-*  
21           *nicipal security issued by an issuer that, but for the*  
22           *application of section 2(b) of the Investment Com-*  
23           *pany Act of 1940 (15 U.S.C. 80a-2(b)), would con-*  
24           *stitute an investment company within the meaning of*



1           (D) the potential or actual conflicts of inter-  
2 est (or both potential and actual conflicts) cre-  
3 ated by soft dollar arrangements, including  
4 whether certain potential conflicts are being  
5 managed effectively by other laws and regula-  
6 tions specifically addressing those situations, the  
7 role of the board of directors in managing these  
8 potential or actual (or both) conflicts, and the ef-  
9 fectiveness of the board in this capacity;

10           (E) the transparency of such soft dollar ar-  
11 rangements to investment company shareholders  
12 and investment advisory clients of investment  
13 advisers, the extent to which enhanced disclosure  
14 is necessary or appropriate to enable investors to  
15 better understand the impact of these arrange-  
16 ments, and an assessment of whether the cost of  
17 any enhanced disclosure or other regulatory  
18 change would result in benefits to the investor;  
19 and

20           (F) whether such section 28(e) should be  
21 modified, and whether other regulatory or legis-  
22 lative changes should be considered and adopted  
23 to benefit investors.

24           (b) *REPORT REQUIRED.*—The Commission shall sub-  
25 mit a report on the study required by subsection (a) to the

1 *Committee on Financial Services of the House of Represent-*  
2 *atives and the Committee on Banking, Housing, and Urban*  
3 *Affairs of the Senate, no later than one year after the date*  
4 *of enactment of this Act.*

5 **SEC. 14. STUDY OF ARBITRATION CLAIMS.**

6       (a) *STUDY REQUIRED.*—*The Securities and Exchange*  
7 *Commission shall conduct a study of the increased rate of*  
8 *arbitration claims and decisions involving mutual funds*  
9 *since 1995 for the purposes of identifying trends in arbitra-*  
10 *tion claim rates and, if applicable, the causes of such in-*  
11 *creased rates and the means to avert such causes.*

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

**Union Calendar No. 205**

108TH CONGRESS  
1ST SESSION

**H. R. 2420**

**[Report No. 108-351]**

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**A BILL**

To improve transparency relating to the fees and costs that mutual fund investors incur and to improve corporate governance of mutual funds.

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NOVEMBER 4, 2003

Reported with an amendment, committed to the Committee of the Whole House on the State of the Union, and ordered to be printed