AN ACT

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,
SECTION 1. SHORT TITLE.

(a) SHORT TITLE.—This Act may be cited as the “Mutual Funds Integrity and Fee Transparency Act of 2003”.

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6 TITLE I—INTEGRITY AND FEE TRANSPARENCY

7 SEC. 101. IMPROVED TRANSPARENCY OF MUTUAL FUND COSTS.

(a) REGULATION REVISION REQUIRED.—Within 270 days after the date of enactment of this Act, the Securities and Exchange Commission shall revise regulations under the Securities Act of 1933, the Securities Exchange Act of 1934, or the Investment Company Act of 1940, or any
combination thereof, to require, consistent with the protec-
tion of investors and the public interest, improved disclo-
sure with respect to an open-end management investment
company, in the quarterly statement or other periodic re-
port to shareholders or other appropriate disclosure docu-
ment, of the following:

(1) The estimated amount, in dollars for each
$1,000 of investment in the company, of the oper-
ating expenses of the company that are borne by
shareholders.

(2) The structure of, or method used to deter-
mine, the compensation of individuals employed by
the investment adviser of the company to manage
the portfolio of the company, and the ownership in-
terest of such individuals in the securities of the
company.

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

(4) Information concerning the company’s poli-
cies and practices with respect to the payment of
commissions for effecting securities transactions to a
member of an exchange, broker, or dealer who—
(A) furnishes advice, either directly or through publications or writings, as to the value of securities, the advisability of investing in, purchasing, or selling securities, and the availability of securities or purchasers or sellers of securities;

(B) furnishes analyses and reports concerning issuers, industries, securities, economic factors and trends, portfolio strategy, and the performance of accounts; or

(C) facilitates the sale and distribution of the company’s shares.

(5) Information concerning payments by any person other than the company that are intended to facilitate the sale and distribution of the company’s shares.

(6) Information concerning discounts on front-end sales loads for which investors may be eligible, including the minimum purchase amounts required for such discounts.

(b) APPROPRIATE DISCLOSURE DOCUMENT.—

(1) IN GENERAL.—For purposes of subsection (a), a disclosure shall not be considered to be made in an appropriate disclosure document if the disclosure is made exclusively in a prospectus or state-
ment of additional information, or both such docu-
ments.

(2) **Exceptions.**—Notwithstanding paragraph (1), the disclosures required by paragraph (2) and (4) of subsection (a) may be considered to be made in an appropriate disclosure document if the disclosure is made exclusively in a prospectus or state-
ment of additional information, or both such docu-
ments.

(c) **Concept Release Required.**—

(1) **In General.**—The Commission shall issue a concept release examining the issue of portfolio transaction costs incurred by investment companies, including commission, spread, opportunity, and mar-
ket impact costs, with respect to trading of portfolio securities and how such costs may be disclosed to mutual fund investors in a manner that will enable investors to compare such costs among funds.

(2) **Report and Recommendations Required.**—The Commission shall submit a report on the findings from the concept release required by paragraph (1), as well as legislative and regulatory recommendations, if any, to the Committee on Fi-
nancial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Af-
fairs of the Senate, no later than 270 days after the date of enactment of this Act.

(d) ADDITIONAL REQUIREMENT FOR FEE STATEMENT.—

(1) IN GENERAL.—Not later than 270 days after the date of enactment of this Act, the Commission shall prescribe a rule to require, with respect to an open-end management investment company, in the quarterly statement or other periodic report, or other appropriate disclosure document, a statement informing shareholders that such shareholders have paid fees on their investments, that such fees have been deducted from the amounts shown on the statements, and where such shareholders may find additional information regarding the amount of these fees.

(2) APPROPRIATE DISCLOSURE DOCUMENT.—The statement required by paragraph (1) shall not be considered to be made in an appropriate disclosure document unless such statement is—

(A) made in each periodic statement to a shareholder that discloses the value of the holdings of the shareholder in the securities of the company; and
(B) prominently displayed, in a location in close proximity to the statement of the shares account value.

(e) Reducing Burdens on Small Funds.—In prescribing rules under this section, the Commission shall give consideration to methods for reducing for small investment companies the burdens of making the disclosures required by such rules, consistent with the public interest and the protection of investors.

SEC. 102. OBLIGATIONS REGARDING CERTAIN DISTRIBUTION AND SOFT DOLLAR ARRANGEMENTS.

(a) Reporting Requirement.—Section 15 of the Investment Company Act of 1940 (15 U.S.C. 80a–15) is amended by adding at the end the following new subsection:

“(g) Obligations Regarding Certain Distribution and Soft Dollar Arrangements.—

“(1) Reporting requirements.—Each investment adviser to a registered investment company shall, no less frequently than annually, submit to the board of directors of the company a report on—

“(A) payments during the reporting period by the adviser (or an affiliated person of the adviser) that were directly or indirectly made for the purpose of promoting the sale of shares
of the investment company (referred to in para-
graph (2) as a ‘revenue sharing arrangement’);

“(B) services to the company provided or
paid for by a broker or dealer or an affiliated
person of the broker or dealer (other than bro-
kerage and research services) in exchange for
the direction of brokerage to the broker or deal-
er (referred to in paragraph (2) as a ‘directed
brokerage arrangement’); and

“(C) research services obtained by the ad-
viser (or an affiliated person of the adviser)
during the reporting period from a broker or
dealer the receipt of which may reasonably be
attributed to securities transactions effected on
behalf of the company or any other company
that is a member of the same group of invest-
ment companies (referred to in paragraph (2)
as a ‘soft dollar arrangement’).

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

“(A) to review the investment adviser’s di-
rection of the company’s brokerage trans-
actions, including directed brokerage arrange-
ments and soft dollar arrangements, and to de-
termine that the direction of such brokerage is
in the best interests of the shareholders of the
company; and

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

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

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

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

“(A) the term ‘brokerage and research
services’ has the same meaning as in section
28(e)(3) of the Securities Exchange Act of 1934; and

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

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

(1) if any research services (as such term is defined in section 15(g)(5)(B) of the Investment Company Act of 1940, as amended by subsection (a) of this section)—

(A) are provided by a member of an exchange, broker, or dealer who effects securities transactions in an account, and

(B) are prepared or provided by a party that is unaffiliated with such member, broker, or dealer,

any person exercising investment discretion with respect to such account shall maintain a copy of the written contract between the person preparing such research and the member of an exchange, broker, or dealer; and
(2) such contract shall describe the nature and value of the services provided.

**SEC. 103. MUTUAL FUND GOVERNANCE.**

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

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

(1) in subparagraph (A)—

(A) by striking clause (vi) and redesignating clause (vii) as clause (vi); and

(B) by amending clause (v) to read as follows:

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

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

(2) in subparagraph (B)—

(A) by striking clause (vi) and redesignating clause (vii) as clause (vi); and

(B) by amending clause (v) to read as follows:

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

“(I) a material business or professional relationship with such investment adviser or principal underwriter (or affiliated person thereof), or

“(II) a close familial relationship with a natural person who is such investment adviser or principal underwriter (or affiliated person thereof),”.
SEC. 104. AUDIT COMMITTEE REQUIREMENTS FOR INVESTMENT COMPANIES.

(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 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 new sentence: “The Commission, by rule, regulation, or order, may exempt a registered management company or registered face-amount certificate
company subject to this subsection from the re-

quirement 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 new sub-
section:

“(d) Audit Committee Requirements.—

“(1) Requirements as prerequisite to fil-
ing financial statements.—Any registered man-
agement company or registered face-amount certifi-
cate company that files with the Commission any fi-
nancial statement signed or certified by an inde-
dependent public accountant shall comply with the re-
quirements of paragraphs (2) through (6) of this
subsection and any rule or regulation of the Com-
mision issued thereunder.

“(2) Responsibility relating to inde-
dependent public accountants.—The audit com-
mittee of the registered company, in its capacity as
a committee of the board of directors, shall be di-
rectly responsible for the appointment, compensa-
tion, and oversight of the work of any independent
public accountant employed by such registered com-
pany (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 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 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 company or the investment adviser or principal underwriter of the registered company; or
“(ii) be an ‘interested person’ of the registered company, as such term is defined in section 2(a)(19).

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

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

“(B) the confidential, anonymous submission by employees of the registered 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 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 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 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 is amended by adding at the end the following new paragraph:

“(7) EXEMPTION FOR INVESTMENT COMPANIES.—Effective one year after the date of enactment of the Mutual Funds Integrity and Fee Transparency Act of 2003, 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.—Not later than 180 days after the date of enactment of this Act, the Securities and Exchange 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. 105. TRADING RESTRICTIONS.

Subsection (e) of section 22 of the Investment Company Act of 1940 (15 U.S.C. 80a–22(e)) is amended to read as follows:

“(e) TRADING RESTRICTIONS.—

“(1) PROHIBITION AND EXCEPTIONS.—No registered investment company shall suspend the right of redemption, or postpone the date of payment or satisfaction upon redemption of any redeemable security in accordance with its terms for more than seven days after the tender of such security to the company or its agents designated for that purpose for redemption, except—

“(A) for any period (i) during which the principal market for the securities in which the company invests is closed, other than customary week-end and holiday closings; or (ii) during which trading on such exchange is restricted;
“(B) for any period during which an emergency exists as a result of which (i) disposal by
the company of securities owned by it is not reasonably practicable; or (ii) it is not reason-
ably practicable for such company fairly to de-
terminate the value of its net assets; or
“(C) for such other periods as the Com-
mision may by order permit for the protection
of security holders of the company.
“(2) COMMISSION RULES.—The Commission
shall by rules and regulations—
“(A) determine the conditions under which
trading shall be deemed to be restricted;
“(B) determine the conditions under which
an emergency shall be deemed to exist; and
“(C) provide for the determination by each
company, subject to such limitations as the
Commission shall determine are necessary and
appropriate for the protection of investors, of
the principal market for the securities in which
the company invests.”.

SEC. 106. DEFINITION OF NO-LOAD MUTUAL FUND.

Within 270 days after the date of enactment of this
Act, the Securities and Exchange Commission shall, by
rule adopted by the Commission or a self-regulatory organ-
ization (or both)—

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

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

SEC. 107. INFORMING DIRECTORS OF SIGNIFICANT DEFI-
CIENTIES.

Section 42 of the Investment Company Act of 1940
(15 U.S.C. 80a–41) is amended by adding at the end the
following new subsection:

“(f) INFORMING DIRECTORS OF SIGNIFICANT DEFI-
CIENCIES.—If the report of an inspection by the Com-
mission of a registered investment company identifies signifi-
cant deficiencies in the operations of such company, or of
its investment adviser or principal underwriter, the com-
pany shall provide such report to the directors of such
company.”.
SEC. 108. EXEMPTION FROM IN PERSON MEETING REQUIREMENTS.

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

SEC. 109. PROXY VOTING DISCLOSURE.

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

“(k) PROXY VOTING DISCLOSURE.—Every registered management 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 registrant’s proxy voting record for the most recent twelve-month period ending on June 30. The financial statements of every such company shall state that information regarding how the company voted proxies relating to portfolio securities during the most recent 12-month period ending on June 30 is available—
“(1) 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

“(2) on the Commission’s website.”.

SEC. 110. INCENTIVE COMPENSATION AND MUTUAL FUND SALES.

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

(1) the amount and source of sales fees, payments by persons other than the investment company that are intended to facilitate the sale and distribution of the securities, and commissions for effecting portfolio securities transactions, or other payments, paid to such broker or dealer, or municipal securities broker or dealer, or associated person thereof in connection with such sale;
(2) any commission or other fees or charges the investor has paid or will or might be subject to, including as a result of purchases or redemptions;

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

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

(b) BENCHMARKS.—In connection with the rule required by subsection (a), the Commission shall, to the extent practical, establish standards for such disclosures.

(e) DEFINITIONS.—

(1) DIFFERENTIAL COMPENSATION.—For purposes of this section, an associated person of a broker or dealer shall be considered to receive differential compensation if such person receives any increased or additional remuneration, in whatever form—

(A) for sales of the securities of an investment company or municipal fund security that is affiliated with, or otherwise specifically des-
igned by, such broker or dealer or municipal
securities broker or dealer, as compared with
the remuneration for sales of securities of an
investment company or municipal fund security
offered by such broker or dealer or municipal
securities broker or dealer that are not so affili-
ated or designated; or

(B) for the sale of any class of securities
of an investment company or municipal fund se-
curity as compared with the remuneration for
the sale of a class of securities of such invest-
ment company or municipal fund security (of-
fered by such broker or dealer or municipal se-
curities broker or dealer) that charges a sales
load (as defined in section 2(a)(35) of the In-
vestment Company Act of 1940 (15 U.S.C.
80a–2(a)(35)) only at the time of such a sale.

(2) Municipal fund security.—For pur-
poses of this section, a municipal fund security is
any municipal security issued by an issuer that, but
for the application of section 2(b) of the Investment
Company Act of 1940 (15 U.S.C. 80a–2(b)), would
constitute an investment company within the mean-
ing of section 3 of the Investment Company Act of
SEC. 111. COMMISSION STUDY AND REPORT REGULATING

SOFT DOLLAR ARRANGEMENTS.

(a) Study Required.—

(1) In general.—The Commission shall conduct a study of the use of soft dollar arrangements by investment advisers as contemplated by section 28(e) of the Securities Exchange Act of 1934 (15 U.S.C. 78bb(e)).

(2) Areas of consideration.—The study required by this section shall examine—

(A) the trends in the average amounts of soft dollar commissions paid by investment advisers and investment companies in the past 3 years;

(B) the types of services provided through soft dollar arrangements;

(C) the benefits and disadvantages of the use of soft dollars for investors, including the extent to which use of soft dollar arrangements affects the ability of mutual fund investors to evaluate and compare the expenses of different mutual funds;

(D) the potential or actual conflicts of interest (or both potential and actual conflicts) created by soft dollar arrangements, including whether certain potential conflicts are being
managed effectively by other laws and regulations specifically addressing those situations, the role of the board of directors in managing these potential or actual (or both) conflicts, and the effectiveness of the board in this capacity;

(E) the transparency of such soft dollar arrangements to investment company shareholders and investment advisory clients of investment advisers, the extent to which enhanced disclosure is necessary or appropriate to enable investors to better understand the impact of these arrangements, and an assessment of whether the cost of any enhanced disclosure or other regulatory change would result in benefits to the investor; and

(F) whether such section 28(e) should be modified, and whether other regulatory or legislative changes should be considered and adopted to benefit investors.

(b) REPORT REQUIRED.—The Commission shall submit a report on the study required by subsection (a) to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate, no later than one year after the date of enactment of this Act.
SEC. 112. STUDY OF ARBITRATION CLAIMS.

(a) Study Required.—The Securities and Exchange Commission shall conduct a study of the increased rate of arbitration claims and decisions involving mutual funds since 1995 for the purposes of identifying trends in arbitration claim rates and, if applicable, the causes of such increased rates and the means to avert such causes.

(b) Report.—The Securities and Exchange Commission shall submit a report on the study required by subsection (a) to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate not later than one year after the date of enactment of this Act.

TITLE II—PREVENTION OF ABUSIVE MUTUAL FUND PRACTICES

SEC. 201. PREVENTION OF FRAUD; INTERNAL COMPLIANCE AND CONTROL PROCEDURES.

(a) Amendment.—Subsection (j) of section 17 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 and regulations 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.—Such rules and regulations shall include requirements for the adoption of codes of ethics by registered investment companies 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 com-
pany and in such additional form and manner as the
Commission shall require by rule or regulation.

“(3) ADDITIONAL COMPLIANCE PROCEDURES.—
Such rules and regulations shall—

“(A) require each investment company and
investment adviser registered with the Commiss-
ion to adopt and implement policies and proce-
dures reasonably designed to prevent violation
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.), the Trust In-
denture Act of 1939 (15 U.S.C. 77aaa et seq.),
the Investment Company Act of 1940 (15
U.S.C. 80a–1 et seq.), the Investment Advisers
Act of 1940 (15 U.S.C. 80b et seq.), the Secu-
rities 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
et seq.), or section 21 of the Federal Deposit
Insurance Act (12 U.S.C. 1829b);
“(B) require each such company and adviser to review such policies and procedures annually for their adequacy and the effectiveness of their implementation;

“(C) require each such 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 such 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 no 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; and

“(D) require each such company to establish policies and procedures reasonably designed to protect any officer, director, employee, contractor, subcontractor, or agent of such com-
pany from retaliation, including discharge, de-
motion, suspension, harassment, or any other
manner of discrimination in the terms and con-
ditions of employment, because of any lawful
act done by such officer, director, employee,
contractor, subcontractor, or agent to provide
information, cause information to be provided,
or otherwise assist in an investigation that re-
lates to any conduct which such officer, direc-
tor, employee, contractor, subcontractor, or
agent reasonably believes constitutes a violation
of the securities laws or the code of ethics of
such investment company.

“(4) SELF-CERTIFICATION.—Such rules and
regulations shall require the members of the board
of directors who are not interested persons of each
registered open-end investment company to certify,
in the periodic report to shareholders, or other ap-
propriate 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, re-
demption, and sale complies with the require-
ments of the Investment Company Act of 1940
and the rules and regulations thereunder, and
the company is in compliance with such proce-
dures;

“(B) procedures are in place for the over-
sight of the flow of funds into and out of the
securities of the company, and the company is
in compliance with such procedures;

“(C) procedures are in place to ensure that
investors are receiving any applicable discounts
on front-end sales loads that are disclosed in
the company’s prospectus;

“(D) procedures are in place to ensure
that, if the company’s shares are offered as dif-
ferent classes of shares, such classes are de-
signed in the interests of investors, and could
reasonably be an appropriate investment option
for an investor;

“(E) procedures are in place to ensure that
information about the company’s portfolio secu-
rities is not disclosed in violation of the securi-
ties laws or the company’s code of ethics;

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

“(G) the company has established and enforces a code of ethics as required by paragraph (2) of this subsection; and

“(H) the company is in compliance with the additional requirements of paragraph (3) of this subsection.”.

(b) DEADLINE FOR RULES.—The Securities and Exchange Commission shall prescribe rules to implement the amendment made by subsection (a) of this section within 90 days after the date of enactment of this Act.

SEC. 202. 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 further amended by adding at the end the following new subsection:

“(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 in-
dividual 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 con-
flicts in the selection of the portfolio securities.

“(2) EXCEPTIONS.—Notwithstanding para-
graph (1), the Commission may, by rule, regulation,
or order, permit joint management by a portfolio
manager in exceptional circumstances when nec-
essary to protect the interest of investors, provided
that such rule, regulation, or order requires—

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

“(B) fair and equitable policies and proce-
dures for the allocation of securities to the port-
folios of the jointly managed companies, and
certification by the members of the board of di-
rectors who are not interested persons of such
registered open-end investment company, in the
periodic report to shareholders, or other appro-
priate 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 Securities and Exchange Commission shall prescribe rules to implement the amendment made by subsection (a) of this section within 90 days after the date of enactment of this Act.

SEC. 203. SHORT TERM TRADING BY INTERESTED PERSONS PROHIBITED.

(a) Short Term Trading Prohibited.—Section 17 of the Investment Company Act of 1940 (15 U.S.C. 80a–17) is further amended by adding at the end the following new subsection:

“(k) Short Term Trading Prohibited.—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 com-
pany, or any officer, director, partner, or employee of such
an affiliated person, investment adviser, or principal un-
derwriter, to engage in short-term transactions, as such
term is defined by the Commission by rule, in any securi-
ties of which such company, or any affiliate of such com-
pany, is the issuer, except that this subsection shall not
prohibit transactions in money market funds, other funds
the investment policy of which expressly permits short-
term transactions, or such other categories of registered
investment companies as the Commission shall specify by
rule.”.

(b) Increased Redemption Fees Permitted for
Short Term Trading.—Within 90 days after the date
of enactment of this Act, the Securities and Exchange
Commission shall revise rule 11a–3 of its rules under the
Investment Company Act of 1940 (17 CFR 270.11a–30),
or other rules of the Commission, as necessary to permit
an investment company to charge redemption fees in ex-
cess 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 prevent short term trading that is unfair to the
shareholders of such company.

(c) Deadline for Rules.—The Securities and Ex-
change Commission shall prescribe rules to implement the
amendment made by subsection (a) of this section within
90 days after the date of enactment of this Act.

SEC. 204. ELIMINATION OF STALE PRICES.
Within 90 days after the date of enactment of this
Act, the Securities and Exchange Commission shall pre-
scribe, by rule or regulation, standards concerning the ob-
ligation of registered open-end 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 accu-
rately reflect the fair market value of the companies’ port-
folio securities, in order to prevent dilution of the interests
of long-term investors or as necessary in the other inter-
est of investors. Such rule or regulation shall identify,
in addition to significant events, the conditions or cir-
cumstances from which such obligation will arise, such as
the need to value securities traded on foreign exchanges,
and the methods by which fair value methods shall be ap-
plied in such events, conditions, and circumstances.

SEC. 205. PREVENTION OF UNFAIR AFTER-HOURS TRADING.
(a) ADDITIONAL RULES REQUIRED.—Within 90 days
after the date of enactment of this Act, the Securities and
Exchange Commission shall issue rules to prevent trans-
actions in the securities of any registered open-end invest-
ment 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.—Such rules shall permit execution of such after-hours trades that are provided to the registered open-end investment company by a broker-dealer, retirement plan administrator, or other intermediary, after the time as of which such net asset value was determined, if such trades are collected by such intermediaries subject to procedures that are—

(1) designed to prevent the acceptance of trades by such intermediaries after the time as of which net asset value was determined; and

(2) subject to an independent annual audit to verify that the procedures do not permit the acceptance of trades after the time as of which such net asset value was determined.

(c) Independently Maintained Systems.—Such rules shall permit firms that utilize computer systems and procedures provided by unaffiliated entities to collect transactions to satisfy the independent audit requirements under subsection (b)(2) by means of an independent audit obtained by such unaffiliated entity.
SEC. 206. REPORT ON ADEQUACY OF REMEDIAL ACTIONS.

(a) REPORT REQUIRED.—Within 180 days of enactment, the Securities and Exchange Commission shall submit a report to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate on market timing and late trading of mutual funds.

(b) REQUIRED CONTENTS OF REPORT.—The report required by this section shall include the following:

(1) The economic harm of market timing and late trading of mutual fund shares on long-term mutual fund shareholders.

(2) The findings by the Commission’s Office of Compliance, Inspections and Examinations, and the actions taken by the Commission’s Division of Enforcement, regarding—

   (A) illegal late trading practices;

   (B) illegal market timing practices; and

   (C) market timing practices that are not in violation of prospectus disclosures.

(3) When the Commission became aware that the use of market timing practices was harming long-term shareholders, and the circumstances surrounding the Commission’s discovery of that activity.
(4) The steps the Commission has taken since becoming aware of market timing practices to protect long-term mutual fund investors.

(5) Any additional legislative or regulatory action that is necessary to protect long-term mutual fund shareholders against the detrimental effects of late trading and market timing practices.

Passed the House of Representatives November 19, 2003.

Attest: JEFF TRANDAHL,

Clerk.