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

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 Investor Confidence Restoration Act of 2003”.

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

Sec. 1. Short title; table of contents.
TITLE I—ENHANCING COST, FEE, AND OTHER DISCLOSURES TO SHAREHOLDERS

Sec. 101. Improved transparency of mutual fund costs.
Sec. 102. Obligations regarding certain distribution and soft dollar arrangements.
Sec. 103. Definition of no-load mutual fund.
Sec. 104. Disclosure of incentive compensation and mutual fund sales.

TITLE II—MUTUAL FUND GOVERNANCE

Sec. 201. Independent mutual fund boards.
Sec. 202. Audit committee requirements for investment companies.
Sec. 203. Informing directors of significant deficiencies.
Sec. 204. Certification by chairman and chief compliance officer.

TITLE III—PREVENTING ABUSIVE MUTUAL FUND PRACTICES

Sec. 301. Prevention of fraud; internal compliance and control procedures.
Sec. 302. Ban on joint management of mutual funds and hedge funds.
Sec. 303. Restrictions on short term trading and mandatory redemption fees.
Sec. 304. Elimination of stale prices.
Sec. 305. Formal policies and procedures related to market timing.
Sec. 306. Prevention of late trades.
Sec. 307. Disclosure of insider transactions.

TITLE IV—STRENGTHENING MUTUAL FUND INDUSTRY OVERSIGHT

Sec. 401. Study of Mutual Fund Oversight Board.
Sec. 402. Study of coordination of enforcement efforts.
Sec. 403. Review of Commission resources.
Sec. 404. Commission study and report regulating soft dollar arrangements.
Sec. 405. Report on adequacy of regulatory response to late trading and market timing.
Sec. 406. Study of arbitration claims.

TITLE V—PROMOTING SHAREHOLDER LITERACY

Sec. 501. Financial literacy among mutual fund investors study.

1 TITLE I—ENHANCING COST, FEE, AND OTHER DISCLOSURES TO SHAREHOLDERS

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

6 (a) Regulation Revision Required.—

7 (1) In general.—Not later than 180 days after the date of enactment of this Act, the Securi-
ties and Exchange Commission shall revise regula-
tions under the Securities Act of 1933, the Securi-
ties Exchange Act of 1934, or the Investment Com-
pany Act of 1940, or any combination thereof, to re-
quire, consistent with the protection of investors and
the public interest, improved disclosure with respect
to an open-end management investment company, in
the quarterly statement or other periodic report to
shareholders or other appropriate disclosure docu-
ment, of—

(A) the actual dollar amount, borne by
each shareholder, of the expenses of the com-
pany;

(B) the structure of, method used to deter-
mine, and the total amount of the compensation
of individuals employed by the investment ad-
viser of the company to manage the portfolio of
the company, and the ownership interest of
such individuals in the securities of the com-
pany, including when such individuals have no
ownership interest in the company;

(C) whether the chairman of the board of
directors of the open-end management invest-
ment company or any directors of the invest-
ment adviser of such company employed to
manage the portfolio of the company do not own any securities of the company;

(D) the estimated total annual dollar amount of fees, costs, expenses, taxes, and any other payments made by the company for any purpose, excluding only pro rata distributions to shareholders, and set forth in a manner that facilitates comparison among different companies;

(E) information concerning the company’s policies and practices with respect to the payment of commissions for effecting securities transactions to a member of an exchange, broker, or dealer who—

(i) 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;

(ii) furnishes analyses and reports concerning issuers, industries, securities, economic factors and trends, portfolio strategy, and the performance of accounts; or
(iii) facilitates the sale and distribution of the company’s shares;

(F) information concerning payments by any person other than the company that are intended to facilitate the sale and distribution of the company’s shares; and

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

(2) Rules and regulations.—

(A) Other management and service-related cost.—Not later than 180 days after the date of enactment of this Act, the Securities and Exchange Commission shall issue rules or regulations defining “fees, costs, expenses, taxes, and any other payments made by the company” for purposes of paragraph (1)(D). Such definition shall include any management fees, transfer agency expenses, custodial fees, shareholder servicing fees, portfolio transaction costs (including commissions, market impact, spread, and opportunity costs, fees charged under a plan adopted pursuant to rule 12b–1 of the rules of the Securities and Exchange Com-
mission (17 C.F.R. 270.12b–1), and other distribution expenses, directors’ fees, and registration fees.

(B) MANNER THAT FACILITATES COMPARISON AMONG INVESTMENT COMPANIES.—

(i) In general.—Not later than 180 days after the date of enactment of this Act, the Securities and Exchange Commission shall issue rules or regulations defining “manner that facilitates comparison amount investment companies” for purposes of paragraph (1)(D). Such definition shall include definitions of functional categories of fees, costs, expenses, taxes, and other payments disclosed under paragraph (1)(D) that shall not be based on the contract under which or with whom the services are provided, and shall instead be based on the nature of the services provided.

(ii) Display.—Each category of costs under clause (i) shall be presented in a graphical display (such as a bar or pie chart) that shows each category as a per-
(C) Certification.—Not later than 90 days after the date of enactment of this Act, the Securities and Exchange Commission shall issue rules or regulations requiring the independent audit of the estimate required under paragraph (1)(D) and certification by the investment adviser and the chairman of the board of directors of the open-end investment company.

(b) Appropriate Disclosure Document.—

(1) In general.—For purposes of subsection (a)(1), a disclosure shall not be considered to be made in an appropriate disclosure document if the disclosure is made exclusively in a prospectus or statement of additional information, or both such documents.

(2) Exceptions.—Notwithstanding paragraph (1), the disclosures required by paragraph (1)(B), (C), and (E) of subsection (a) may be considered to be made in an appropriate disclosure document if the disclosure is made exclusively in a prospectus or statement of additional information, or both such documents.
SEC. 102. OBLIGATIONS REGARDING CERTAIN DISTRIBUTION AND SOFT DOLLAR ARRANGEMENTS.

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

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

“(1) Reporting Requirements.—Each investment adviser to a registered investment company shall, not 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 paragraph (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 brokerage and research services) in exchange for the direction of brokerage to the broker or dealer (referred to in paragraph (2) as a ‘directed brokerage arrangement’); and

“(C) research services obtained by the adviser (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 that
the direction of such brokerage adheres to the
Fund’s stated policies and is in the best inter-
ests 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 that
such revenue sharing arrangements adheres to
the Fund’s stated policies and 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 paragraph (4), annual reports to shareholders of a registered 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 section, which rules and regulations shall, among other things, prescribe the content of the required reports.

“(5) DEFINITION.—For purposes of this subsection—

“(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.”.

SEC. 103. DEFINITION OF NO-LOAD MUTUAL FUND.

Not later than 180 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 organization (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 rules of the Securities and Exchange Commission (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. 104. DISCLOSURE OF INCENTIVE COMPENSATION AND MUTUAL FUND SALES.

(a) IN GENERAL.—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) CONFIRMATION OF TRANSACTIONS FOR MUTUAL FUNDS.—

“(A) IN GENERAL.—Each broker shall disclose in writing to customers that purchase the shares of an open-end company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a–8)—

“(i) the amount of any compensation received or to be received by the broker in connection with such transaction from any sources, including—

“(I) the amount and source of sales fees, payments by persons other than the investment company that are
intended to facilitate the sale and dis-
tribution of the securities, and com-
missions for effecting portfolio securi-
ties transactions, or other payments,
paid to such broker or dealer, or mu-
nicipal securities broker or dealer, or
associated person thereof in connec-
tion with such sale;

“(II) any commission or other
fees or charges the investor has paid
or will or might be subject to, includ-
ing as a result of purchases or re-
demptions;

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

“(IV) information about the esti-
imated amount of any asset-based dis-
tribution expenses incurred, or to be
incurred, by the investment company
in connection with the purchase of securities by the investor; and

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

“(B) TIMING OF DISCLOSURE.—The disclosure required under subparagraph (A) shall be made to a customer not later than as of the date of the completion of the transaction.

“(C) LIMITATION.—The disclosures required under subparagraph (A) may not be made exclusively in—

“(i) a registration statement or prospectus of an open-end company; or

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

“(D) COMMISSION AUTHORITY.—Not later than 1 year after the date of enactment of the Mutual Fund Investor Confidence Restoration Act of 2003, the Commission shall, by rule, establish, to the extent practicable, standards for the disclosures required under subparagraph (A).

“(E) DEFINITION OF OPEN-END COMPANY.—In this paragraph, the term ‘open-end company’ has the same meaning as in section

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“(F) Definitions of differential compensation and municipal fund security.—

“(i) Differential compensation.—In this paragraph, 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—

“(I) for sales of the securities of an investment company or municipal fund security that is affiliated with, or otherwise specifically designated 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 affiliated or designated; or
“(II) for the sale of any class of securities of an investment company or municipal fund security as compared with the remuneration for the sale of a class of securities of such investment company or municipal fund security (offered by such broker or dealer or municipal securities broker or dealer) that charges a sales load (as defined in section 2(a)(35) of the Investment Company Act of 1940 (15 U.S.C. 80a–2(a)(35)) only at the time of such a sale.

“(ii) MUNICIPAL FUND SECURITY.—In this paragraph, 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 meaning of section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a–3).”
TITLE II—MUTUAL FUND
GOVERNANCE

SEC. 201. INDEPENDENT MUTUAL FUND BOARDS.

(a) DIRECTOR INDEPENDENCE.—

(1) IN GENERAL.—Section 10(a) of the Investment Company Act of 1940 (15 U.S.C. 80a–10(a)) is amended—

(A) by striking “more than 60 percent” and inserting “more than 25 percent”;

and

(B) by striking the period at the end and inserting “, and such company shall not have as a member of its board of directors any person—

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

“(2) unless such director is an interested person or 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

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with such service provider, that is likely to impair
the independence of the director.”.

(2) CHAIRMAN; FINANCIAL EXPERT; INDE-
PENDENT COMMITTEE.—Section 10 of the Invest-
ment Company Act of 1940 (15 U.S.C. 80a–10) is
amended by adding at the end the following:

“(i) CHAIRMAN.—No registered investment company
shall have as chairman of its board of directors an inter-
ested person of such registered company.

“(j) 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 invest-
ment company shall establish a committee comprised
solely of such members, which committee shall be re-
sponsible for—

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

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

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

“(k) FINANCIAL EXPERT.—
“(1) IN GENERAL.—Each registered investment company shall have as a member of its board of directors not less than 1 member who is a financial expert, as such term is defined by the Commission.

“(2) RULES DEFINING FINANCIAL EXPERT.—In defining the term ‘financial expert’ for purposes of paragraph (1), the Commission shall consider whether a person has, through education and experience as a public accountant or auditor or principal financial officer, comptroller, or principal accounting officer of a registered investment company, or from a position involving the performance of similar functions—

“(A) an understanding of generally accepted accounting principles and financial statements; and

“(B) experience in the preparation or auditing of financial statements of general comparable registered investment companies.

“(3) DEADLINE FOR RULEMAKING.—Not later than 180 days after the date of enactment of the Mutual Fund Investor Confidence Restoration Act of 2003, the Commission shall issue rules under paragraph (2).”
(c) 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) 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 con-
trolling, controlled by, or under the com-
mon control with such service provider; or

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

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

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

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

(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, deter-
mines 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 (15 U.S.C. 80a–2(a)) is amended by adding at the end the following:

“(53) Significant service provider.—

“(A) In general.—Not later than 180 days after the date of enactment of the Mutual Fund Investor Confidence Restoration Act of 2003, the Securities and Exchange 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. 202. 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 reg-
istered 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 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 com-
mittee of the registered 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 such registered 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 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 reg-
istered 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 compensa-

tion—

“(A) to the independent public accountant
employed by the registered company for the
purpose of rendering or issuing the audit re-
port; 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) es-

tablished by and among the board of directors
of a registered investment company for the pur-
pose 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 re-
spect to a registered investment company, the
entire board of directors of the company.”.

(b) CONFORMING AMENDMENT.—Section 10A(m)
1934 is amended by adding at the end the following:

“(7) EXEMPTION FOR INVESTMENT COMPAN-
IES.—Effective 1 year after the date of enactment
of the Mutual Fund Investor Confidence Restoration
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.—

(1) IN GENERAL.—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.

(2) INCENTIVES.—Not later than 180 days after the date of enactment of this Act, the Securities and Exchange Commission shall, by rule, establish—

(A) a program of incentives to encourage the filing of meritorious complaints under section 32(d)(4)(A) of the Investment Company Act of 1940; and

(B) appropriate penalties for the willful filing of materially false complaints under such section.
SEC. 203. INFORMING DIRECTORS OF SIGNIFICANT DEFICIENCIES.

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

“(f) INFORMING DIRECTORS OF SIGNIFICANT DEFICIENCIES.—

“(1) IN GENERAL.—If the report of an inspection by the Commission of a registered investment company identifies significant deficiencies in the operations of such company, or of its investment adviser or principal underwriter, the company shall provide such report to the directors of such company.

“(2) DISCLOSURE OF DEFICIENCIES.—The Commission shall, on an annual basis, review all inspection reports of registered investment companies and publicly disclose the 10 most common deficiencies cited in those reports.”.

SEC. 204. CERTIFICATION BY CHAIRMAN AND CHIEF COMPLIANCE OFFICER.

(a) IN GENERAL.—Subsection (j) of section 17 of the Investment Company Act of 1940 (15 U.S.C. 80a–17(j)), as amended by section 301 of this Act, is amended by adding at the end the following:
“(4) Certification by Chairman.—The rules and regulations established under paragraph (1) shall require the chairman of the board of directors of each registered open-end investment company to certify, in the 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 the Investment Company Act of 1940 and the rules and regulations thereunder, and the company is in compliance with such procedures;

“(B) procedures are in place for the oversight 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 different classes of shares, such classes are designed 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 securities is not disclosed in violation of the securities 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(e);

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

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

“(I) the report submitted to the board of directors under section 15(g)(1) is complete and accurate; and
“(J) the board of directors has fulfilled its obligations under section 15(g)(2).”

“(5) Certification by Chief Compliance Officer.—The rules and regulations established under paragraph (1) shall require the chief compliance officer of each registered open-end investment company to certify, on an annual basis, that—

“(A) appropriate internal controls are in place for the review required under subparagraphs (A) through (H) of paragraph (4); and

“(B) such internal controls have been reviewed, and determined to reasonably achieve their stated purpose, by the chief compliance officer.

“(6) Review of Advisory Contracts.—The rules and regulations established under paragraph (1) shall require that the chairman of the board of directors and the chief compliance officer of a registered open-end investment company certify, on an annual basis, that any advisory contract entered into by the company and associated management fees have been negotiated and are in the best interests of the company.”.
(b) **Deadline for Rules.**—Not later than 90 days after the date of enactment of this Act, the Securities and Exchange Commission shall prescribe—

(1) rules to implement subsection (a); and

(2) minimum standards for compliance with the certification requirements of paragraphs (4) and (5) of section 17(j) of the Investment Company Act of 1940 (15 U.S.C. 80a–17(j)).

**Title III—Preventing Abusive Mutual Fund Practices**

**Sec. 301. 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, di-
rectly 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.—The rules and regulations established under paragraph (1) 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 company and in such addi-
tional form and manner as the Commission shall re-
quire by rule or regulation.

“(3) ADDITIONAL COMPLIANCE PROCEDURES.—
The rules and regulations established under para-
graph (1) 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-
rity 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 ad-
viser to review such policies and procedures an-
nually 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, ensur-
ing that the practices of the company adhere to
those policies and procedures, and promote the
interest of shareholders—

“(i) whose compensation shall be ap-
proved by the members of the board of di-
rectors of the company who are not inter-
ested 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 annu-
ally; 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 estab-

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 irresponsible


tractor, subcontractor, or agent of such company from retaliation, including discharge, demotion, suspension, harassment, or any other manner of discrimination in the terms and conditions 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 relates to any conduct which such officer, director, employee, contractor, subcontractor, or agent reasonably believes constitutes a violation of the securities laws or the code of ethics of such investment company.”.

(b) DEADLINE FOR RULES.—Not later than 90 days after the date of enactment of this Act, the Securities and Exchange Commission shall prescribe rules to implement subsection (a).

SEC. 302. 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:

“(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 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 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 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. 303. RESTRICTIONS ON SHORT TERM TRADING AND 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.—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 short-term transactions, as such term is defined by the Commission by rule, in any securities of which such company, or any affiliate of such company, 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) MANDATORY REDEMPTION FEES.—Not later than 180 days after the date of enactment of this Act, the Securities and Exchange Commission shall, by rule, require that any 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.

(c) DEADLINE FOR RULES.—Not later than 180 days after the date of enactment of this Act, the Securities and Exchange Commission shall prescribe rules to implement the amendment made by subsection (a) of this section.
SEC. 304. ELIMINATION OF STALE PRICES.

(a) In General.—Not later than 180 days after the date of enactment of this Act, the Securities and Exchange Commission shall prescribe, by rule or regulation, standards concerning the obligation 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 accurately reflect the fair market value of the companies’ portfolio securities, in order to prevent dilution of the interests of long-term investors or as necessary in the other interests of investors. Such rule or regulation shall identify, in addition to significant events, the conditions or circumstances 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 applied in such events, conditions, and circumstances.

(b) Formal Policies and Procedures.—

(1) In General.—Not later than 180 days after the date of enactment of this Act, the Securities and Exchange Commission shall, by rule or regulation—

(A) require that each registered open-end investment company and registered investment advisor establish formal policies with respect to
compliance with the regulations established under subsection (a);

(B) require such policies to be publicly disclosed to shareholders;

(C) require the adoption of internal procedures to ensure compliance with such policies;

(D) require that such policies be subject to ongoing review by the company or investment adviser; and

(E) require, on an annual basis, a certification by the chief executive officer of the company or investment adviser that such policies are being adhered to.

(2) CHANGES TO POLICIES.—Any policies adopted by a registered open-end company or registered investment adviser under paragraph (1) shall not be altered without the prior approval of a majority of the shareholders of such company or adviser.

SEC. 305. FORMAL POLICIES AND PROCEDURES RELATED TO MARKET TIMING.

(a) IN GENERAL.—Not later than 180 days after the date of enactment of this Act, the Securities and Exchange Commission shall, by rule—

(1) require that each registered open-end investment company and registered investment advisor
establish formal policies with respect to whether it permits market timing and short term trading, and under what circumstances such practices will be permitted;

(2) require such policies to be publicly disclosed in any prospectus delivered by the company or investment advisor;

(3) require the adoption of internal procedures reasonably designed to ensure compliance with such policies;

(4) require that such policies be subject to ongoing review by the company or investment advisor; and

(5) require, on an annual basis, a certification by the chief executive officer of the investment adviser, and chairman of the board of directors and chief compliance officer of the company that such policies are being adhered to by the investment adviser or the company.

SEC. 306. PREVENTION OF LATE TRADES.

(a) ADDITIONAL RULES REQUIRED.—Not later than 180 days after the date of enactment of this Act, the Securities and Exchange Commission shall issue rules to prevent transactions in the securities of any registered open-end 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.—

(1) In General.—The rules established under subsection (a) shall permit execution of after-hours trades that are provided to the registered open-end investment company by a broker-dealer, retirement plan administrator, insurance company, or other intermediary, after the time as of which such net asset value was determined, if the late trading and detection procedures and policies of such intermediary are subject to inspection by the Commission (in this subsection, a “permitted intermediary”).

(2) Rules.—The Commission, by rule, shall—

(A) require each permitted intermediary to certify that it has policies and procedures in place to prevent and detect late-trades, and that such policies have been adhered to by the permitted intermediary;

(B) require each permitted intermediary to submit an independent annual audit verifying that its policies and procedures do not permit the acceptance of late order trading; and
(C) provide that any intermediary that is
not a permitted intermediary shall be required
to submit all transactions to the open-end in-
vestment company before the determination of
the related net asset value.

SEC. 307. DISCLOSURE OF INSIDER TRANSACTIONS.

Not later than 180 days after the date of enactment
of this Act, the Securities and Exchange Commission
shall, by rule, require—

(1) that any senior executive officer of an open-
end management investment company publicly dis-
close, prior to the actual time of purchase, any in-
tended sale or purchase of securities of an open-end
management investment company that employs the
same investment adviser as the company with whom
such senior executive officer is employed; and

(2) that any such securities purchased be held
by the senior executive officer for not less than 6
months.

TITLE IV—STRENGTHENING MU-
TUAL FUND INDUSTRY OVER-
sIGHT

SEC. 401. STUDY OF MUTUAL FUND OVERSIGHT BOARD.

(a) IN GENERAL.—The General Accounting Office
shall conduct a study to determine the feasibility of, and
assess what, if any, benefits to shareholders, mutual fund governance and mutual fund supervision would result from establishing a Mutual Fund Oversight Board that would—

(1) have inspection, examination, and enforcement authority over mutual fund boards of directors;

(2) be funded by assessments against mutual fund assets or management fees;

(3) have members selected by Commission; and

(4) have rulemaking authority.

(b) REPORT.—Not later than 1 year after the date of enactment of this Act, the General Accounting Office shall submit a report on the study required under paragraph (1) 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. 402. STUDY OF COORDINATION OF ENFORCEMENT EFFORTS.

(a) IN GENERAL.—The General Accounting Office shall conduct a study of the coordination of enforcement efforts related to allegations of misconduct by open-end management companies between the headquarters of the Securities and Exchange Commission, the regional offices of the Commission, and appropriate State regulatory and
law enforcement entities, such as State attorneys general and the North American Securities Administrators Association.

(b) REPORT.—Not later than 1 year after the date of enactment of this Act, the General Accounting Office shall submit a report on the study required under subsection (a) to Congress.

SEC. 403. REVIEW OF COMMISSION RESOURCES.

(a) IN GENERAL.—The Securities and Exchange Commission shall conduct a study on the allocation and adequacy of the supervision and enforcement resources of the Commission dedicated to the oversight of open-end management companies.

(b) REPORT.—Not later than 1 year after the date of enactment of this Act, the Securities and Exchange Commission shall submit a report on 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. 404. 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 share-
holders and investment advisory clients of in-
vestment 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 legis-
lative changes should be considered and adopted
to benefit investors.

(b) REPORT REQUIRED.—Not later than 1 year after
the date of enactment of this Act, 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.
SEC. 405. REPORT ON ADEQUACY OF REGULATORY RESPONSE TO LATE TRADING AND MARKET TIMING.

(a) REPORT REQUIRED.—Not later than 180 days after the date of enactment of this Act, 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 sur-
rounding the Commission’s discovery of that activity.

(4) The steps the Commission has taken since
becoming aware of market timing practices to pro-
tect long-term mutual fund investors.

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

SEC. 406. STUDY OF ARBITRATION CLAIMS.

(a) Study Required.—The Securities and Ex-
change 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.—Not later than 1 year after the date
of enactment of this Act, 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.
TITLE V—PROMOTING SHAREHOLDER LITERACY

SEC. 501. FINANCIAL LITERACY AMONG MUTUAL FUND INVESTORS STUDY.

(a) In General.—The Securities and Exchange Commission shall conduct a study to identify—

(1) the existing level of financial literacy among investors that purchase shares of open-end companies, as such term is defined under section 5 of the Investment Company Act of 1940, that are registered under section 8 of such Act;

(2) the most useful and understandable relevant information that investors need to make sound financial decisions prior to purchasing such shares;

(3) methods to increase the transparency of expenses and potential conflicts of interest in transactions involving the shares of open-end companies;

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

(5) a strategy to increase the financial literacy of investors that results in a positive change in investor behavior.

(b) Report.—Not later than 1 year after the date of enactment of this Act, the Securities and Exchange
Commission shall submit a report on 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.