

108TH CONGRESS
1ST SESSION

S. 1971

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

IN THE SENATE OF THE UNITED STATES

NOVEMBER 25, 2003

Mr. CORZINE (for himself, Mr. DODD, and Mr. LIEBERMAN) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

A BILL

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

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

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

4 (a) SHORT TITLE.—This Act may be cited as the
5 “Mutual Fund Investor Confidence Restoration Act of
6 2003”.

7 (b) TABLE OF CONTENTS.—The table of contents for
8 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,**
 2 **AND OTHER DISCLOSURES TO**
 3 **SHAREHOLDERS**

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

6 (a) REGULATION REVISION REQUIRED.—

- 7 (1) IN GENERAL.—Not later than 180 days
 8 after the date of enactment of this Act, the Securi-

1 ties and Exchange Commission shall revise regula-
2 tions under the Securities Act of 1933, the Securi-
3 ties Exchange Act of 1934, or the Investment Com-
4 pany Act of 1940, or any combination thereof, to re-
5 quire, consistent with the protection of investors and
6 the public interest, improved disclosure with respect
7 to an open-end management investment company, in
8 the quarterly statement or other periodic report to
9 shareholders or other appropriate disclosure docu-
10 ment, of—

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

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

22 (C) whether the chairman of the board of
23 directors of the open-end management invest-
24 ment company or any directors of the invest-
25 ment adviser of such company employed to

1 manage the portfolio of the company do not
2 own any securities of the company;

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

9 (E) information concerning the company's
10 policies and practices with respect to the pay-
11 ment of commissions for effecting securities
12 transactions to a member of an exchange,
13 broker, or dealer who—

14 (i) furnishes advice, either directly or
15 through publications or writings, as to the
16 value of securities, the advisability of in-
17 vesting in, purchasing, or selling securities,
18 and the availability of securities or pur-
19 chasers or sellers of securities;

20 (ii) furnishes analyses and reports
21 concerning issuers, industries, securities,
22 economic factors and trends, portfolio
23 strategy, and the performance of accounts;
24 or

1 (iii) facilitates the sale and distribu-
2 tion of the company's shares;

3 (F) information concerning payments by
4 any person other than the company that are in-
5 tended to facilitate the sale and distribution of
6 the company's shares; and

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

11 (2) RULES AND REGULATIONS.—

12 (A) OTHER MANAGEMENT AND SERVICE-
13 RELATED COST.—Not later than 180 days after
14 the date of enactment of this Act, the Securities
15 and Exchange Commission shall issue rules or
16 regulations defining “fees, costs, expenses,
17 taxes, and any other payments made by the
18 company” for purposes of paragraph (1)(D).
19 Such definition shall include any management
20 fees, transfer agency expenses, custodial fees,
21 shareholder servicing fees, portfolio transaction
22 costs (including commissions, market impact,
23 spread, and opportunity costs, fees charged
24 under a plan adopted pursuant to rule 12b–1 of
25 the rules of the Securities and Exchange Com-

1 mission (17 C.F.R. 270.12b-1), and other dis-
2 tribution expenses, directors' fees, and registra-
3 tion fees.

4 (B) MANNER THAT FACILITATES COMPARI-
5 SON AMONG INVESTMENT COMPANIES.—

6 (i) IN GENERAL.—Not later than 180
7 days after the date of enactment of this
8 Act, the Securities and Exchange Commis-
9 sion shall issue rules or regulations defin-
10 ing “manner that facilitates comparison
11 amount investment companies” for pur-
12 poses of paragraph (1)(D). Such definition
13 shall include definitions of functional cat-
14 egories of fees, costs, expenses, taxes, and
15 other payments disclosed under paragraph
16 (1)(D) that shall not be based on the con-
17 tract under which or with whom the serv-
18 ices are provided, and shall instead be
19 based on the nature of the services pro-
20 vided.

21 (ii) DISPLAY.—Each category of costs
22 under clause (i) shall be presented in a
23 graphical display (such as a bar or pie
24 chart) that shows each category as a per-

1 centage of the total dollar amount under
2 paragraph (1)(D).

3 (C) CERTIFICATION.—Not later than 90
4 days after the date of enactment of this Act,
5 the Securities and Exchange Commission shall
6 issue rules or regulations requiring the inde-
7 pendent audit of the estimate required under
8 paragraph (1)(D) and certification by the in-
9 vestment adviser and the chairman of the board
10 of directors of the open-end investment com-
11 pany.

12 (b) APPROPRIATE DISCLOSURE DOCUMENT.—

13 (1) IN GENERAL.—For purposes of subsection
14 (a)(1), a disclosure shall not be considered to be
15 made in an appropriate disclosure document if the
16 disclosure is made exclusively in a prospectus or
17 statement of additional information, or both such
18 documents.

19 (2) EXCEPTIONS.—Notwithstanding paragraph
20 (1), the disclosures required by paragraph (1)(B),
21 (C), and (E) of subsection (a) may be considered to
22 be made in an appropriate disclosure document if
23 the disclosure is made exclusively in a prospectus or
24 statement of additional information, or both such
25 documents.

1 **SEC. 102. OBLIGATIONS REGARDING CERTAIN DISTRIBUTION AND SOFT DOLLAR ARRANGEMENTS.**
2

3 Section 15 of the Investment Company Act of 1940
4 (15 U.S.C. 80a-15) is amended by adding at the end the
5 following:

6 “(g) OBLIGATIONS REGARDING CERTAIN DISTRIBUTION AND SOFT DOLLAR ARRANGEMENTS.—

8 “(1) REPORTING REQUIREMENTS.—Each investment adviser to a registered investment company
9 shall, not less frequently than annually, submit to
10 the board of directors of the company a report on—

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

18 “(B) services to the company provided or
19 paid for by a broker or dealer or an affiliated
20 person of the broker or dealer (other than brokerage and research services) in exchange for
21 the direction of brokerage to the broker or dealer (referred to in paragraph (2) as a ‘directed
22 brokerage arrangement’); and
23

25 “(C) research services obtained by the adviser (or an affiliated person of the adviser)
26

1 during the reporting period from a broker or
2 dealer, the receipt of which may reasonably be
3 attributed to securities transactions effected on
4 behalf of the company or any other company
5 that is a member of the same group of invest-
6 ment companies (referred to in paragraph (2)
7 as a ‘soft dollar arrangement’).

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

11 “(A) to review the investment adviser’s di-
12 rection of the company’s brokerage trans-
13 actions, including directed brokerage arrange-
14 ments and soft dollar arrangements, and that
15 the direction of such brokerage adheres to the
16 Fund’s stated policies and is in the best inter-
17 ests of the shareholders of the company; and

18 “(B) to review any revenue sharing ar-
19 rangements to ensure compliance with this Act
20 and the rules adopted thereunder, and that
21 such revenue sharing arrangements adheres to
22 the Fund’s stated policies and are in the best
23 interests of the shareholders of the company.

24 “(3) SUMMARIES OF REPORTS IN ANNUAL RE-
25 PORTS TO SHAREHOLDERS.—In accordance with reg-

1 ulations prescribed by the Commission under para-
 2 graph (4), annual reports to shareholders of a reg-
 3 istered investment company shall include a summary
 4 of the most recent report submitted to the board of
 5 directors under paragraph (1).

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

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

12 “(A) the term ‘brokerage and research
 13 services’ has the same meaning as in section
 14 28(e)(3) of the Securities Exchange Act of
 15 1934; and

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

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

20 Not later than 180 days after the date of enactment
 21 of this Act, the Securities and Exchange Commission
 22 shall, by rule adopted by the Commission or a self-regu-
 23 latory organization (or both)—

24 (1) clarify the definition of “no-load” as such
 25 term is used by investment companies that impose

1 any fee under a plan adopted pursuant to rule 12b-
2 1 of the rules of the Securities and Exchange Com-
3 mission (17 C.F.R. 270.12b-1); and

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

7 **SEC. 104. DISCLOSURE OF INCENTIVE COMPENSATION AND**
8 **MUTUAL FUND SALES.**

9 (a) IN GENERAL.—Section 15(b) of the Securities
10 Exchange Act of 1934 (15 U.S.C. 78o(b)) is amended by
11 adding at the end the following:

12 “(11) CONFIRMATION OF TRANSACTIONS FOR
13 MUTUAL FUNDS.—

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

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

23 “(I) the amount and source of
24 sales fees, payments by persons other
25 than the investment company that are

1 intended to facilitate the sale and dis-
2 tribution of the securities, and com-
3 missions for effecting portfolio securi-
4 ties transactions, or other payments,
5 paid to such broker or dealer, or mu-
6 nicipal securities broker or dealer, or
7 associated person thereof in connec-
8 tion with such sale;

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

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

21 “(IV) information about the esti-
22 mated amount of any asset-based dis-
23 tribution expenses incurred, or to be
24 incurred, by the investment company

1 in connection with the purchase of se-
2 curities by the investor; and

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

5 “(B) TIMING OF DISCLOSURE.—The dis-
6 closure required under subparagraph (A) shall
7 be made to a customer not later than as of the
8 date of the completion of the transaction.

9 “(C) LIMITATION.—The disclosures re-
10 quired under subparagraph (A) may not be
11 made exclusively in—

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

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

16 “(D) COMMISSION AUTHORITY.—Not later
17 than 1 year after the date of enactment of the
18 Mutual Fund Investor Confidence Restoration
19 Act of 2003, the Commission shall, by rule, es-
20 tablish, to the extent practicable, standards for
21 the disclosures required under subparagraph
22 (A).

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

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

3 “(F) DEFINITIONS OF DIFFERENTIAL
4 COMPENSATION AND MUNICIPAL FUND SECUR-
5 RITY.—

6 “(i) DIFFERENTIAL COMPENSA-
7 TION.—In this paragraph, an associated
8 person of a broker or dealer shall be con-
9 sidered to receive differential compensation
10 if such person receives any increased or
11 additional remuneration, in whatever
12 form—

13 “(I) for sales of the securities of
14 an investment company or municipal
15 fund security that is affiliated with, or
16 otherwise specifically designated by,
17 such broker or dealer or municipal se-
18 curities broker or dealer, as compared
19 with the remuneration for sales of se-
20 curities of an investment company or
21 municipal fund security offered by
22 such broker or dealer or municipal se-
23 curities broker or dealer that are not
24 so affiliated or designated; or

1 “(II) for the sale of any class of
2 securities of an investment company
3 or municipal fund security as com-
4 pared with the remuneration for the
5 sale of a class of securities of such in-
6 vestment company or municipal fund
7 security (offered by such broker or
8 dealer or municipal securities broker
9 or dealer) that charges a sales load
10 (as defined in section 2(a)(35) of the
11 Investment Company Act of 1940 (15
12 U.S.C. 80a-2(a)(35)) only at the time
13 of such a sale.

14 “(ii) MUNICIPAL FUND SECURITY.—
15 In this paragraph, a municipal fund secu-
16 rity is any municipal security issued by an
17 issuer that, but for the application of sec-
18 tion 2(b) of the Investment Company Act
19 of 1940 (15 U.S.C. 80a-2(b)), would con-
20 stitute an investment company within the
21 meaning of section 3 of the Investment
22 Company Act of 1940 (15 U.S.C. 80a-
23 3).”.

1 **TITLE II—MUTUAL FUND**
2 **GOVERNANCE**

3 **SEC. 201. INDEPENDENT MUTUAL FUND BOARDS.**

4 (a) DIRECTOR INDEPENDENCE.—

5 (1) IN GENERAL.—Section 10(a) of the Invest-
6 ment Company Act of 1940 (15 U.S.C. 80a–10(a))
7 is amended—

8 (A) by striking “more than 60 per cen-
9 tum” and inserting “more than 25 percent”;
10 and

11 (B) by striking the period at the end and
12 inserting “, and such company shall not have as
13 a member of its board of directors any per-
14 son—

15 “(1) who has served without being approved or
16 elected by the shareholders of such registered invest-
17 ment company at least once every 5 years; and

18 “(2) unless such director is an interested per-
19 son or has been found, on an annual basis, by a ma-
20 jority of the directors who are not interested per-
21 sons, after reasonable inquiry by such directors, not
22 to have any material business or familial relationship
23 with the registered investment company, a signifi-
24 cant service provider to the company, or any entity
25 controlling, controlled by, or under common control

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

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

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

10 “(j) INDEPENDENT COMMITTEE.—

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

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

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

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

25 “(k) FINANCIAL EXPERT.—

1 “(1) IN GENERAL.—Each registered investment
2 company shall have as a member of its board of di-
3 rectors not less than 1 member who is a financial
4 expert, as such term is defined by the Commission.

5 “(2) RULES DEFINING FINANCIAL EXPERT.—In
6 defining the term ‘financial expert’ for purposes of
7 paragraph (1), the Commission shall consider wheth-
8 er a person has, through education and experience
9 as a public accountant or auditor or principal finan-
10 cial officer, comptroller, or principal accounting offi-
11 cer of a registered investment company, or from a
12 position involving the performance of similar func-
13 tions—

14 “(A) an understanding of generally accept-
15 ed accounting principles and financial state-
16 ments; and

17 “(B) experience in the preparation or au-
18 diting of financial statements of general com-
19 parable registered investment companies.

20 “(3) DEADLINE FOR RULEMAKING.—Not later
21 than 180 days after the date of enactment of the
22 Mutual Fund Investor Confidence Restoration Act of
23 2003, the Commission shall issue rules under para-
24 graph (2).”.

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

4 (1) in subparagraph (A)—

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

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

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

18 “(viii) any natural person who has
19 served as an officer or director, or as an
20 employee within the preceding 10 fiscal
21 years, of any entity that has within the
22 preceding 5 fiscal years acted as a signifi-
23 cant service provider to such registered in-
24 vestment company, or of any entity con-

1 trolling, controlled by, or under the com-
2 mon control with such service provider; or

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

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

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

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

18 (2) in subparagraph (B)—

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

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

23 “(vii) any natural person who is a
24 member of a class of persons that the
25 Commission, by rule or regulation, deter-

1 mines is unlikely to exercise an appropriate
2 degree of independence as a result of—

3 “(I) a material business relation-
4 ship with such investment adviser or
5 principal underwriter or affiliated per-
6 son of such investment adviser or
7 principal underwriter;

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

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

14 (d) DEFINITION OF SIGNIFICANT SERVICE PRO-
15 VIDER.—Section 2(a) of the Investment Company Act of
16 1940 (15 U.S.C. 80a–2(a)) is amended by adding at the
17 end the following:

18 “(53) SIGNIFICANT SERVICE PROVIDER.—

19 “(A) IN GENERAL.—Not later than 180
20 days after the date of enactment of the Mutual
21 Fund Investor Confidence Restoration Act of
22 2003, the Securities and Exchange Commission
23 shall issue final rules defining the term ‘signifi-
24 cant service provider’.

1 “(B) REQUIREMENTS.—The definition de-
2 veloped under paragraph (1) shall include, at a
3 minimum, the investment adviser and principal
4 underwriter of a registered investment company
5 for purposes of paragraph (19).”.

6 **SEC. 202. AUDIT COMMITTEE REQUIREMENTS FOR INVEST-**
7 **MENT COMPANIES.**

8 (a) AMENDMENTS.—Section 32 of the Investment
9 Company Act of 1940 (15 U.S.C. 80a–31) is amended—
10 (1) in subsection (a)—

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

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

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

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

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

13 (2) by adding at the end the following:

14 “(d) AUDIT COMMITTEE REQUIREMENTS.—

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

24 “(2) RESPONSIBILITY RELATING TO INDE-
 25 PENDENT PUBLIC ACCOUNTANTS.—The audit com-

1 mittee of the registered company, in its capacity as
2 a committee of the board of directors, shall be di-
3 rectly responsible for the appointment, compensa-
4 tion, and oversight of the work of any independent
5 public accountant employed by such registered com-
6 pany (including resolution of disagreements between
7 management and the auditor regarding financial re-
8 porting) for the purpose of preparing or issuing the
9 audit report or related work, and each such inde-
10 pendent public accountant shall report directly to
11 the audit committee.

12 “(3) INDEPENDENCE.—

13 “(A) IN GENERAL.—Each member of the
14 audit committee of the registered company shall
15 be a member of the board of directors of the
16 company, and shall otherwise be independent.

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

24 “(i) accept any consulting, advisory,
25 or other compensatory fee from the reg-

1 istered company or the investment adviser
2 or principal underwriter of the registered
3 company; or

4 “(ii) be an ‘interested person’ of the
5 registered company, as such term is de-
6 fined in section 2(a)(19).

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

9 “(A) the receipt, retention, and treatment
10 of complaints received by the registered com-
11 pany regarding accounting, internal accounting
12 controls, or auditing matters; and

13 “(B) the confidential, anonymous submis-
14 sion by employees of the registered company
15 and its investment adviser or principal under-
16 writer of concerns regarding questionable ac-
17 counting or auditing matters.

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

23 “(6) FUNDING.—The registered company shall
24 provide appropriate funding, as determined by the
25 audit committee, in its capacity as a committee of

1 the board of directors, for payment of compensa-
2 tion—

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

7 “(B) to any advisers employed by the audit
8 committee under paragraph (5).

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

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

17 “(B) if no such committee exists with re-
18 spect to a registered investment company, the
19 entire board of directors of the company.”.

20 (b) CONFORMING AMENDMENT.—Section 10A(m)
21 (15 U.S.C. 78j-1(m)) of the Securities Exchange Act of
22 1934 is amended by adding at the end the following:

23 “(7) EXEMPTION FOR INVESTMENT COMPA-
24 NIES.—Effective 1 year after the date of enactment
25 of the Mutual Fund Investor Confidence Restoration

1 Act of 2003, for purposes of this subsection, the
2 term ‘issuer’ shall not include any investment com-
3 pany that is registered under section 8 of the Invest-
4 ment Company Act of 1940.”.

5 (c) IMPLEMENTATION.—

6 (1) IN GENERAL.—Not later than 180 days
7 after the date of enactment of this Act, the Securi-
8 ties and Exchange Commission shall issue final reg-
9 ulations to carry out section 32(d) of the Investment
10 Company Act of 1940, as added by subsection (a) of
11 this section.

12 (2) INCENTIVES.—Not later than 180 days
13 after the date of enactment of this Act, the Securi-
14 ties and Exchange Commission shall, by rule, estab-
15 lish—

16 (A) a program of incentives to encourage
17 the filing of meritorious complaints under sec-
18 tion 32(d)(4)(A) of the Investment Company
19 Act of 1940; and

20 (B) appropriate penalties for the willful fil-
21 ing of materially false complaints under such
22 section.

1 **SEC. 203. INFORMING DIRECTORS OF SIGNIFICANT DEFICIENCIES.**
2

3 Section 42 of the Investment Company Act of 1940
4 (15 U.S.C. 80a-41) is amended by adding at the end the
5 following:

6 “(f) INFORMING DIRECTORS OF SIGNIFICANT DEFICIENCIES.—
7

8 “(1) IN GENERAL.—If the report of an inspection
9 by the Commission of a registered investment
10 company identifies significant deficiencies in the operations
11 of such company, or of its investment adviser or principal
12 underwriter, the company shall provide such report to the
13 directors of such company.
14

15 “(2) DISCLOSURE OF DEFICIENCIES.—The
16 Commission shall, on an annual basis, review all inspection
17 reports of registered investment companies and publicly disclose
18 the 10 most common deficiencies cited in those reports.”
19

20 **SEC. 204. CERTIFICATION BY CHAIRMAN AND CHIEF COMPLIANCE OFFICER.**
21

22 (a) IN GENERAL.—Subsection (j) of section 17 of the
23 Investment Company Act of 1940 (15 U.S.C. 80a-17(j)),
24 as amended by section 301 of this Act, is amended by adding
25 at the end the following:

1 “(4) CERTIFICATION BY CHAIRMAN.—The rules
2 and regulations established under paragraph (1)
3 shall require the chairman of the board of directors
4 of each registered open-end investment company to
5 certify, in the periodic report to shareholders, or
6 other appropriate disclosure document, that—

7 “(A) procedures are in place for verifying
8 that the determination of current net asset
9 value of any redeemable security issued by the
10 company used in computing periodically the
11 current price for the purpose of purchase, re-
12 demption, and sale complies with the require-
13 ments of the Investment Company Act of 1940
14 and the rules and regulations thereunder, and
15 the company is in compliance with such proce-
16 dures;

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

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

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

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

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

17 “(G) the company has established and en-
18 forces a code of ethics as required by paragraph
19 (2) of this subsection;

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

23 “(I) the report submitted to the board of
24 directors under section 15(g)(1) is complete and
25 accurate; and

1 “(J) the board of directors has fulfilled its
2 obligations under section 15(g)(2).”

3 “(5) CERTIFICATION BY CHIEF COMPLIANCE
4 OFFICER.—The rules and regulations established
5 under paragraph (1) shall require the chief compli-
6 ance officer of each registered open-end investment
7 company to certify, on an annual basis, that—

8 “(A) appropriate internal controls are in
9 place for the review required under subpara-
10 graphs (A) through (H) of paragraph (4); and

11 “(B) such internal controls have been re-
12 viewed, and determined to reasonably achieve
13 their stated purpose, by the chief compliance of-
14 ficer.

15 “(6) REVIEW OF ADVISORY CONTRACTS.—The
16 rules and regulations established under paragraph
17 (1) shall require that the chairman of the board of
18 directors and the chief compliance officer of a reg-
19 istered open-end investment company certify, on an
20 annual basis, that any advisory contract entered into
21 by the company and associated management fees
22 have been negotiated and are in the best interests of
23 the company.”.

1 (b) DEADLINE FOR RULES.—Not later than 90 days
2 after the date of enactment of this Act, the Securities and
3 Exchange Commission shall prescribe—

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

5 (2) minimum standards for compliance with the
6 certification requirements of paragraphs (4) and (5)
7 of section 17(j) of the Investment Company Act of
8 1940 (15 U.S.C. 80a–17(j)).

9 **TITLE III—PREVENTING ABU-**
10 **SIVE MUTUAL FUND PRAC-**
11 **TICES**

12 **SEC. 301. PREVENTION OF FRAUD; INTERNAL COMPLIANCE**
13 **AND CONTROL PROCEDURES.**

14 (a) AMENDMENT.—Subsection (j) of section 17 of the
15 Investment Company Act of 1940 (15 U.S.C. 80a–17(j))
16 is amended to read as follows:

17 “(j) DETECTION AND PREVENTION OF FRAUD.—

18 “(1) COMMISSION RULES TO PROHIBIT FRAUD,
19 DECEPTION, AND MANIPULATION.—It shall be un-
20 lawful for any affiliated person of or principal under-
21 writer for a registered investment company or any
22 affiliated person of an investment adviser of or prin-
23 cipal underwriter for a registered investment com-
24 pany, to engage in any act, practice, or course of
25 business in connection with the purchase or sale, di-

1 rectly or indirectly, by such person of any security
2 held or to be acquired by such registered investment
3 company, or any security issued by such registered
4 investment company or by an affiliated registered in-
5 vestment company, in contravention of such rules
6 and regulations as the Commission may adopt to de-
7 fine, and prescribe means reasonably necessary to
8 prevent, such acts, practices, or courses of business
9 as are fraudulent, deceptive, or manipulative.

10 “(2) CODES OF ETHICS.—The rules and regula-
11 tions established under paragraph (1) shall include
12 requirements for the adoption of codes of ethics by
13 registered investment companies and investment ad-
14 visers of, and principal underwriters for, such invest-
15 ment companies establishing such standards as are
16 reasonably necessary to prevent such acts, practices,
17 or courses of business. Such rules and regulations
18 shall require each such registered investment com-
19 pany to disclose such codes of ethics (and any
20 changes therein) in the periodic report to share-
21 holders of such company, and to disclose such code
22 of ethics and any waivers and material violations
23 thereof on a readily accessible electronic public infor-
24 mation facility of such company and in such addi-

1 tional form and manner as the Commission shall re-
2 quire by rule or regulation.

3 “(3) ADDITIONAL COMPLIANCE PROCEDURES.—
4 The rules and regulations established under para-
5 graph (1) shall—

6 “(A) require each investment company and
7 investment adviser registered with the Commis-
8 sion to adopt and implement policies and proce-
9 dures reasonably designed to prevent violation
10 of the Securities Act of 1933 (15 U.S.C. 78a et
11 seq.), the Securities Exchange Act of 1934 (15
12 U.S.C. 78a et seq.), the Sarbanes-Oxley Act of
13 2002 (15 U.S.C. 7201 et seq.), the Trust In-
14 denture Act of 1939 (15 U.S.C. 77aaa et seq.),
15 the Investment Company Act of 1940 (15
16 U.S.C. 80a–1 et seq.), the Investment Advisers
17 Act of 1940 (15 U.S.C. 80b et seq.), the Secu-
18 rities Investor Protection Act of 1970 (15
19 U.S.C. 78aaa et seq.), subchapter II of chapter
20 53 of title 31, United States Code, chapter 2 of
21 title I of Public Law 91–508 (12 U.S.C. 1951
22 et seq.), or section 21 of the Federal Deposit
23 Insurance Act (12 U.S.C. 1829b);

24 “(B) require each such company and ad-
25 viser to review such policies and procedures an-

1 nually for their adequacy and the effectiveness
2 of their implementation;

3 “(C) require each such company to appoint
4 a chief compliance officer to be responsible for
5 overseeing such policies and procedures, ensur-
6 ing that the practices of the company adhere to
7 those policies and procedures, and promote the
8 interest of shareholders—

9 “(i) whose compensation shall be ap-
10 proved by the members of the board of di-
11 rectors of the company who are not inter-
12 ested persons of such company;

13 “(ii) who shall report directly to the
14 members of the board of directors of the
15 company who are not interested persons of
16 such company, privately as such members
17 request, but no less frequently than annu-
18 ally; and

19 “(iii) whose report to such members
20 shall include any violations or waivers of,
21 and any other significant issues arising
22 under, such policies and procedures; and

23 “(D) require each such company to estab-
24 lish policies and procedures reasonably designed
25 to protect any officer, director, employee, con-

1 tractor, subcontractor, or agent of such com-
 2 pany from retaliation, including discharge, de-
 3 motion, suspension, harassment, or any other
 4 manner of discrimination in the terms and con-
 5 ditions of employment, because of any lawful
 6 act done by such officer, director, employee,
 7 contractor, subcontractor, or agent to provide
 8 information, cause information to be provided,
 9 or otherwise assist in an investigation that re-
 10 lates to any conduct which such officer, direc-
 11 tor, employee, contractor, subcontractor, or
 12 agent reasonably believes constitutes a violation
 13 of the securities laws or the code of ethics of
 14 such investment company.”.

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

19 **SEC. 302. BAN ON JOINT MANAGEMENT OF MUTUAL FUNDS**
 20 **AND HEDGE FUNDS.**

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

24 “(h) BAN ON JOINT MANAGEMENT OF MUTUAL
 25 FUNDS AND HEDGE FUNDS.—

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

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

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

21 “(B) fair and equitable policies and proce-
22 dures for the allocation of securities to the port-
23 folios of the jointly managed companies, and
24 certification by the members of the board of di-
25 rectors who are not interested persons of such

1 registered open-end investment company, in the
 2 periodic report to shareholders, or other appro-
 3 priate disclosure document, that such policies
 4 and procedures of such company are fair and
 5 equitable.

6 “(3) DEFINITION.—For purposes of this sub-
 7 section, the term ‘portfolio manager’ means the indi-
 8 vidual or individuals who are designated as respon-
 9 sible for decision-making in connection with the se-
 10 curities purchased and sold on behalf of a registered
 11 open-end investment company, but shall not include
 12 individuals who participate only in making research
 13 recommendations or executing transactions on behalf
 14 of such company.”.

15 (b) DEADLINE FOR RULES.—The Securities and Ex-
 16 change Commission shall prescribe rules to implement the
 17 amendment made by subsection (a) of this section within
 18 90 days after the date of enactment of this Act.

19 **SEC. 303. RESTRICTIONS ON SHORT TERM TRADING AND**
 20 **MANDATORY REDEMPTION FEES.**

21 (a) SHORT TERM TRADING PROHIBITED.—Section
 22 17 of the Investment Company Act of 1940 (15 U.S.C.
 23 80a–17) is amended by adding at the end the following:

24 “(k) SHORT TERM TRADING PROHIBITED.—It shall
 25 be unlawful for any officer, director, partner, or employee

1 of a registered investment company, any affiliated person,
2 investment adviser, or principal underwriter of such com-
3 pany, or any officer, director, partner, or employee of such
4 an affiliated person, investment adviser, or principal un-
5 derwriter, to engage in short-term transactions, as such
6 term is defined by the Commission by rule, in any securi-
7 ties of which such company, or any affiliate of such com-
8 pany, is the issuer, except that this subsection shall not
9 prohibit transactions in money market funds, other funds
10 the investment policy of which expressly permits short-
11 term transactions, or such other categories of registered
12 investment companies as the Commission shall specify by
13 rule.”.

14 (b) MANDATORY REDEMPTION FEES.—Not later
15 than 180 days after the date of enactment of this Act,
16 the Securities and Exchange Commission shall, by rule,
17 require that any investment company that does not allow
18 for market timing practices to charge a redemption fee
19 upon the short-term redemption of any securities of such
20 company.

21 (c) DEADLINE FOR RULES.—Not later than 180 days
22 after the date of enactment of this Act, the Securities and
23 Exchange Commission shall prescribe rules to implement
24 the amendment made by subsection (a) of this section.

1 **SEC. 304. ELIMINATION OF STALE PRICES.**

2 (a) IN GENERAL.—Not later than 180 days after the
3 date of enactment of this Act, the Securities and Ex-
4 change Commission shall prescribe, by rule or regulation,
5 standards concerning the obligation of registered open-end
6 investment companies under the Investment Company Act
7 of 1940 to apply and use fair value methods of determina-
8 tion of net asset value when market quotations are un-
9 available or do not accurately reflect the fair market value
10 of the companies' portfolio securities, in order to prevent
11 dilution of the interests of long-term investors or as nec-
12 essary in the other interests of investors. Such rule or reg-
13 ulation shall identify, in addition to significant events, the
14 conditions or circumstances from which such obligation
15 will arise, such as the need to value securities traded on
16 foreign exchanges, and the methods by which fair value
17 methods shall be applied in such events, conditions, and
18 circumstances.

19 (b) FORMAL POLICIES AND PROCEDURES.—

20 (1) IN GENERAL.—Not later than 180 days
21 after the date of enactment of this Act, the Securi-
22 ties and Exchange Commission shall, by rule or reg-
23 ulation—

24 (A) require that each registered open-end
25 investment company and registered investment
26 advisor establish formal policies with respect to

1 compliance with the regulations established
2 under subsection (a);

3 (B) require such policies to be publicly dis-
4 closed to shareholders;

5 (C) require the adoption of internal proce-
6 dures to ensure compliance with such policies;

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

10 (E) require, on an annual basis, a certifi-
11 cation by the chief executive officer of the com-
12 pany or investment adviser that such policies
13 are being adhered to.

14 (2) **CHANGES TO POLICIES.**—Any policies
15 adopted by a registered open-end company or reg-
16 istered investment adviser under paragraph (1) shall
17 not be altered without the prior approval of a major-
18 ity of the shareholders of such company or adviser.

19 **SEC. 305. FORMAL POLICIES AND PROCEDURES RELATED**
20 **TO MARKET TIMING.**

21 (a) **IN GENERAL.**—Not later than 180 days after the
22 date of enactment of this Act, the Securities and Ex-
23 change Commission shall, by rule—

24 (1) require that each registered open-end in-
25 vestment company and registered investment advisor

1 establish formal policies with respect to whether it
2 permits market timing and short term trading, and
3 under what circumstances such practices will be per-
4 mitted;

5 (2) require such policies to be publicly disclosed
6 in any prospectus delivered by the company or in-
7 vestment advisor;

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

11 (4) require that such policies be subject to on-
12 going review by the company or investment advisor;
13 and

14 (5) require, on an annual basis, a certification
15 by the chief executive officer of the investment ad-
16 viser, and chairman of the board of directors and
17 chief compliance officer of the company that such
18 policies are being adhered to by the investment ad-
19 viser or the company.

20 **SEC. 306. PREVENTION OF LATE TRADES.**

21 (a) **ADDITIONAL RULES REQUIRED.**—Not later than
22 180 days after the date of enactment of this Act, the Secu-
23 rities and Exchange Commission shall issue rules to pre-
24 vent transactions in the securities of any registered open-
25 end investment company in violation of section 22 of the

1 Investment Company Act of 1940 (15 U.S.C. 80a–22), in-
2 cluding after-hours trades that are executed at a price
3 based on a net asset value that was determined as of a
4 time prior to the actual execution of the transaction.

5 (b) TRADES COLLECTED BY INTERMEDIARIES.—

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

16 (2) RULES.—The Commission, by rule, shall—

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

22 (B) require each permitted intermediary to
23 submit an independent annual audit verifying
24 that its policies and procedures do not permit
25 the acceptance of late order trading; and

1 (C) provide that any intermediary that is
2 not a permitted intermediary shall be required
3 to submit all transactions to the open-end in-
4 vestment company before the determination of
5 the related net asset value.

6 **SEC. 307. DISCLOSURE OF INSIDER TRANSACTIONS.**

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

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

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

20 **TITLE IV—STRENGTHENING MU-**
21 **TUAL FUND INDUSTRY OVER-**
22 **SIGHT**

23 **SEC. 401. STUDY OF MUTUAL FUND OVERSIGHT BOARD.**

24 (a) IN GENERAL.—The General Accounting Office
25 shall conduct a study to determine the feasibility of, and

1 assess what, if any, benefits to shareholders, mutual fund
2 governance and mutual fund supervision would result from
3 establishing a Mutual Fund Oversight Board that would—

4 (1) have inspection, examination, and enforce-
5 ment authority over mutual fund boards of directors;

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

8 (3) have members selected by Commission; and

9 (4) have rulemaking authority.

10 (b) REPORT.—Not later than 1 year after the date
11 of enactment of this Act, the General Accounting Office
12 shall submit a report on the study required under para-
13 graph (1) to—

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

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

18 **SEC. 402. STUDY OF COORDINATION OF ENFORCEMENT EF-**

19 **FORTS.**

20 (a) IN GENERAL.—The General Accounting Office
21 shall conduct a study of the coordination of enforcement
22 efforts related to allegations of misconduct by open-end
23 management companies between the headquarters of the
24 Securities and Exchange Commission, the regional offices
25 of the Commission, and appropriate State regulatory and

1 law enforcement entities, such as State attorneys general
2 and the North American Securities Administrators Asso-
3 ciation.

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

8 **SEC. 403. REVIEW OF COMMISSION RESOURCES.**

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

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

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

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

22 **SEC. 404. COMMISSION STUDY AND REPORT REGULATING**
23 **SOFT DOLLAR ARRANGEMENTS.**

24 (a) STUDY REQUIRED.—

1 (1) IN GENERAL.—The Commission shall con-
2 duct a study of the use of soft dollar arrangements
3 by investment advisers as contemplated by section
4 28(e) of the Securities Exchange Act of 1934 (15
5 U.S.C. 78bb(e)).

6 (2) AREAS OF CONSIDERATION.—The study re-
7 quired by this section shall examine—

8 (A) the trends in the average amounts of
9 soft dollar commissions paid by investment ad-
10 visers and investment companies in the past 3
11 years;

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

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

20 (D) the potential or actual conflicts of in-
21 terest (or both potential and actual conflicts)
22 created by soft dollar arrangements, including
23 whether certain potential conflicts are being
24 managed effectively by other laws and regula-
25 tions specifically addressing those situations,

1 the role of the board of directors in managing
2 these potential or actual (or both) conflicts, and
3 the effectiveness of the board in this capacity;

4 (E) the transparency of such soft dollar
5 arrangements to investment company share-
6 holders and investment advisory clients of in-
7 vestment advisers, the extent to which enhanced
8 disclosure is necessary or appropriate to enable
9 investors to better understand the impact of
10 these arrangements, and an assessment of
11 whether the cost of any enhanced disclosure or
12 other regulatory change would result in benefits
13 to the investor; and

14 (F) whether such section 28(e) should be
15 modified, and whether other regulatory or legis-
16 lative changes should be considered and adopted
17 to benefit investors.

18 (b) REPORT REQUIRED.—Not later than 1 year after
19 the date of enactment of this Act, the Commission shall
20 submit a report on the study required by subsection (a)
21 to the Committee on Financial Services of the House of
22 Representatives and the Committee on Banking, Housing,
23 and Urban Affairs of the Senate.

1 **SEC. 405. REPORT ON ADEQUACY OF REGULATORY RE-**
2 **SPONSE TO LATE TRADING AND MARKET**
3 **TIMING.**

4 (a) **REPORT REQUIRED.**—Not later than 180 days
5 after the date of enactment of this Act, the Securities and
6 Exchange Commission shall submit a report to the Com-
7 mittee on Financial Services of the House of Representa-
8 tives and the Committee on Banking, Housing, and Urban
9 Affairs of the Senate on market timing and late trading
10 of mutual funds.

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

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

16 (2) The findings by the Commission's Office of
17 Compliance, Inspections and Examinations, and the
18 actions taken by the Commission's Division of En-
19 forcement, regarding—

20 (A) illegal late trading practices;

21 (B) illegal market timing practices; and

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

24 (3) When the Commission became aware that
25 the use of market timing practices was harming

1 long-term shareholders, and the circumstances sur-
2 rounding the Commission's discovery of that activity.

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

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

10 **SEC. 406. STUDY OF ARBITRATION CLAIMS.**

11 (a) **STUDY REQUIRED.**—The Securities and Ex-
12 change Commission shall conduct a study of the increased
13 rate of arbitration claims and decisions involving mutual
14 funds since 1995 for the purposes of identifying trends
15 in arbitration claim rates and, if applicable, the causes of
16 such increased rates and the means to avert such causes.

17 (b) **REPORT.**—Not later than 1 year after the date
18 of enactment of this Act, the Securities and Exchange
19 Commission shall submit a report on the study required
20 by subsection (a) to the Committee on Financial Services
21 of the House of Representatives and the Committee on
22 Banking, Housing, and Urban Affairs of the Senate.

1 **TITLE V—PROMOTING**
2 **SHAREHOLDER LITERACY**

3 **SEC. 501. FINANCIAL LITERACY AMONG MUTUAL FUND IN-**
4 **VESTORS STUDY.**

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

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

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

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

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

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

23 (b) REPORT.—Not later than 1 year after the date
24 of enactment of this Act, the Securities and Exchange

1 Commission shall submit a report on the study required
2 under subsection (a) to—

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

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

○