Calendar No. 468

104TH CONGRESS
2d Session

SENATE

REPORT
104–293

THE SECURITIES INVESTMENT PROMOTION ACT OF 1996

R E P O R T

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

TO ACCOMPANY

S. 1815

JUNE 26, 1996.—Ordered to be printed

U.S. GOVERNMENT PRINTING OFFICE
29–010 WASHINGTON : 1996

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

ALFONSE M. D'AMATO, New York, *Chairman*

PHIL GRAMM, Texas
RICHARD C. SHELBY, Alabama
CHRISTOPHER S. BOND, Missouri
CONNIE MACK, Florida
LAUCH FAIRCLOTH, North Carolina
ROBERT F. BENNETT, Utah
ROD GRAMS, Minnesota
PETE V. DOMENICI, New Mexico

PAUL S. SARBANES, Maryland
CHRISTOPHER J. DODD, Connecticut
JOHN F. KERRY, Massachusetts
RICHARD H. BRYAN, Nevada
BARBARA BOXER, California
CAROL MOSELEY-BRAUN, Illinois
PATTY MURRAY, Washington

HOWARD A. MENELL, *Staff Director*
ROBERT J. GIUFFRA, Jr., *Chief Counsel*
PHILIP E. BECHTEL, *Deputy Staff Director*
STEVEN B. HARRIS, *Democratic Staff Director and Chief Counsel*
LAURA S. UNGER, *Counsel*
MITCHELL FEUER, *Democratic Counsel*
GEORGE E. WHITTLE, *Editor*

SUBCOMMITTEE ON SECURITIES

PHIL GRAMM, Texas, *Chairman*

ROBERT F. BENNETT, Utah
RICHARD C. SHELBY, Alabama
LAUCH FAIRCLOTH, North Carolina
ROD GRAMS, Minnesota

CHRISTOPHER J. DODD, Connecticut
PATTY MURRAY, Washington
BARBARA BOXER, California
RICHARD H. BRYAN, Nevada

WAYNE A. ABERNATHY, *Staff Director*
ANDREW LOWENTHAL, *Democratic Professional Staff Member*

(II)

CONTENTS

Calendar No. 468

104TH CONGRESS 2d Session | SENATE | REPORT 104–293

THE SECURITIES INVESTMENT PROMOTION ACT OF 1996

JUNE 26, 1996.—Ordered to be printed

Mr. D'AMATO, from the Committee on Banking, Housing, and Urban Affairs, submitted the following

REPORT

[To accompany S. 1815]

INTRODUCTION

On June 19, 1996, the Senate Committee on Banking, Housing, and Urban Affairs met in legislative session and marked up and ordered to be reported S. 1815, a bill to improve regulation of the securities markets, reduce costs of investing, and for other purposes, with a recommendation that the bill do pass, with an amendment in the nature of a substitute. The Committee's action was taken by a vote of 16 in favor and none opposed.

HISTORY OF THE LEGISLATION

The Securities Investment Promotion Act of 1996, S. 1815, was introduced on May 23, 1996, by Senators Gramm, D'Amato, Dodd, Bryan, and Moseley-Braun. Senators Mack and Bennett were added as cosponsors in the days following. The legislation builds upon two bills previously introduced in the Senate, one of which was adopted by the Senate during the 103rd Congress. Title I of the bill is a revised and updated version of S. 148, the Investment Advisers Integrity Act, introduced on January 4, 1995 by Senator Gramm. Sections 301 through 306 of the bill are drawn from the Small Business Incentive Act of 1993, S. 479, which was introduced on March 2, 1993, by Senators Dodd, D'Amato, Kerry, Bryan, Mack, Domenici, and others, approved by the Committee on September 21, 1993, and adopted by the Senate by a voice vote on November 2, 1993. Section 207 builds upon a concept also contained in S. 479.

The full Committee conducted a legislative hearing on S. 1815 on June 5, 1996. Testimony was received from the Honorable Arthur Levitt, Jr., Chairman of the Securities and Exchange Commission ("SEC" or "Commission"); Christopher W. Brody, Partner, Warburg Pincus & Company, on behalf of the National Venture Capital Association; Matthew Fink, President of the Investment Company Institute; Dee R. Harris, Director, Division of Securities, Arizona Corporation Commission, and President of the North American Securities Administrators Association ("NASAA"), on behalf of NASAA; A.B. Krongard, Chairman and Chief Executive Officer, Alex Brown & Sons, and Chairman of the Securities Industry Association ("SIA"), on behalf of the SIA; Paul Saltzman, Senior Vice President and General Counsel, Public Securities Association; and Mark D. Tomasko, Executive Vice President, Investment Counsel Association of America.

Additional comments, suggestions, and assistance in considering and evaluating the legislation were received from State regulators, staff of the SEC, trade associations, and numerous other private and public individuals. This broad input was essential in the Committee's efforts to produce legislation that enjoys wide public support and consensus within the Committee.

Purpose and Summary

The purpose of this legislation was evidenced by SEC Chairman Levitt in his testimony before the Committee: "The current system of dual federal-state regulation is not the system that Congress—or the Commission—would create today if we were designing a new system * * * An appropriate balance can be attained in the federal-state arena that better allocates responsibilities, reduces compliance costs and facilitates capital formation, while continuing to provide for the protection of investors. The bill's approach to the division of responsibilities in the investment adviser and investment company areas exemplifies such a balance."

While the bill makes amendments to four separate federal securities statutes (the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, and the Investment Advisers Act of 1940) its key provisions, taken together, focus on the need to delineate more clearly the securities law responsibilities of the federal and state governments. Currently, that relationship is a confusing, conflicting, and involves a degree of overlap that may raise costs unnecessarily for American investors and the members of the securities industry. The Committee believes that the reforms in this bill will enhance investor protection while reducing the costs of investing.

Title I of the bill creates a clear division of labor between the states and the federal government for supervision of investment advisers. Currently, while investment advisers are nominally supervised by the SEC and by most states, both are overwhelmed by the size of the task, with more than 22,000 investment advisers currently registered with the SEC. The reality has been that while investment advisers may boast of their registration with the SEC, the SEC has been unable to conduct active supervision of more than a fraction of the advisers registered with the Commission.[1] State securities commissioners have similarly found their resources spread thin. Title I would improve supervision by focusing SEC supervision on investment advisers most likely to be engaged in interstate commerce and focusing state supervision on advisers whose activities are most likely to be centered in their home state.

Title II of the bill recognizes the need to reform the Investment Company Act in keeping with changing technologies and market and investing conditions. Taken together, these provisions will reduce the regulatory costs borne by investment companies, facilitate the ability of investment companies to share timely information with investors, broaden investor choices, and have the effect of further promoting saving and investing in the economy.

Title III contains a number of additional provisions to reduce the cost of saving and investment. Perhaps most significant are provisions that would recognize and strengthen the national markets for mutual funds and stocks. Many mutual funds are traded in a truly national market, today they are still subject to standards set by as many as fifty-two different government authorities. The bill would apply one national standard for registration of securities that trade in a national securities market. At the same time, the bill preserves the legitimate role of the states to enforce their laws against fraudulent actions. Each of the provisions of this Title would remove or reform regulations and regulatory practices and conditions that are outmoded or otherwise serve neither investors nor the companies that employ capital for the creation of jobs and economic growth and opportunity in the United States.

IMPROVED REGULATION OF INVESTMENT ADVISERS

The problem: overlapping responsibilities prevent the best use of resources for adequate supervision

Today there are approximately 22,500 investment advisers registered with the Securities and Exchange Commission. The number of registered investment advisers has increased by over 500% since 1980, far outstripping the growth in the Commission's examination resources. As a result, smaller investment advisers are now examined, on average, once every 44 years—amounting to virtually no regulation at all.[2]

The Committee is concerned about the lack of adequate oversight of the growing number of investment advisers and the impact inadequate regulation may have on investors and American consumers. This is particularly troublesome since many investment advisers hold themselves out to the public as "REGISTERED WITH THE SEC," a statement that may give investors a false sense of confidence—particularly if the investment adviser has never actually been inspected by the SEC and is in little danger of any imminent inspection.

Recognizing the limited resources of both the Commission and the states, the Committee believes that eliminating overlapping

[1] Testimony of Arthur Levitt, Chairman of the U.S. Securities and Exchange Commission concerning S. 1815, the "Securities Investment Promotion Act of 1996," before the Committee on Banking, Housing, and Urban Affairs, June 5, 1996 at Appendix A, p. 2.

[2] Id.

regulatory responsibilities will allow the regulators to make the best use of their scarce resources to protect clients of investment advisers. The states should play an important and logical role in regulating small investment advisers whose activities are likely to be concentrated in their home state. Larger advisers, with national businesses, should be registered with the Commission and be subject to national rules.

The solution: dividing regulatory responsibility

The legislation allows states to assume the primary role with respect to regulating advisers that are small, local businesses, managing less than $25 million in client assets, while the Commission's role is focused on larger advisers with $25 million or more in client assets under management. The Commission will continue to supervise all advisers that are based in a state that does not register investment advisers.

Investment advisers registered with the states will no longer have to register with the SEC. Investment advisers registered with the SEC will no longer have to register with the states but will continue to pay fees to the states. State regulators will enforce books and records and financial responsibility laws for investment advisers registered in their state. Both the Commission and the states will be able to continue bringing anti-fraud actions against investment advisers regardless of whether the investment adviser is registered with the state or the SEC.

Based on data filed with the Commission, this regulatory scheme will leave states with primary responsibility for over 16,000 investment advisers (or almost 72% of Commission registrants) and the Commission responsibility for the remaining 6,300 or so investment advisers. Significantly, those 6,300 investment advisers manage assets totaling approximately 95% of the almost $8 trillion currently overseen by investment advisers—allowing the Commission to concentrate its resources on investment advisers with a national businesses.[3]

The Committee preempts state registration of Commission-registered advisers as well as advisers that are specifically excepted from the definition of investment adviser. Persons who are supervised by advisers registered with the Commission are also preempted from state registration. A "supervised person" includes employees or independent contractors of the investment adviser who are supervised and controlled by the investment adviser and who provide investment advice on its behalf.[4]

The bill generally exempts investment advisers who manage less than $25 million from SEC registration, but provides for some flexibility by giving the Commission authority to grant exemptions from the prohibition. The SEC may exempt from state registration those advisers for whom registration would be "unfair" or a "burden on interstate commerce." The SEC may similarly make exemptions from SEC registration.

[3] Id.

[4] The Internal Revenue Service should not base an indivdual's status as an employee or independent contractor solely on an entity's requirement to supervise that individual under the federa securities laws.

The Committee recognizes that the definition of "assets under management" requires that there be continuous and regular supervisory or management services—a standard which may, in some cases, exclude firms with a national or multistate practice from being able to register with the SEC. The Committee intends the Commission to use its exemptive authority to permit, where appropriate, the registration of such firms with the Commission. The Commission should also use the exemptive authority to address circumstances in which an adviser temporarily does not have $25 million under management. These examples do not serve to limit the SEC's exemptive authority, but merely to illustrate situations the SEC should address promptly.

The SEC may also use its exemptive authority under the bill to raise the $25 million threshold higher as it deems appropriate in keeping with the purposes of the Investment Advisers Act. In testimony before the Committee, Dee R. Harris, testifying on behalf of the NASAA, suggested that the SEC review the appropriateness of that threshold at least every three years. The Committee concurs with NASAA's view on this and recommends it to the SEC. As guidance in the review process, the SEC may want to consider (1) the total number of investment advisers; (2) their geographical locations; (3) their methods of operation; and (4) their methods of operation. The SEC may also want to seek comments from investment advisers, financial planners, state regulators, and other interested parties.

Other improvements to investment adviser regulation

The new regulatory approach envisioned should encourage the state regulators and the SEC to create a uniform filing system for "one stop" filings. A uniform filing system would benefit investors, reduce regulatory and paperwork burdens for registered investment advisers and facilitate supervisory coordination between the states and the SEC.

The Investment Advisers Act now permits the Commission to bar certain individuals who have been convicted of specific crimes primarily involving financial matters or theft from serving as investment advisers. The current limits of the statute create a perverse situation where the SEC can bar an embezzler from the advisory industry, but not a convicted murderer or drug dealer. In a few cases, the Commission has had some difficulty in keeping an obviously unfit felon from registering as an investment adviser. The Committee believes that unfit felons should not be entrusted with the responsibility of giving investment advice and managing client assets. Therefore, the Committee gives the SEC new authority to deny or withdraw the registration of any person convicted of a felony (or of any adviser associated with such a person) to eliminate this problem.

IMPROVING REGULATION OF AND SIMPLIFYING RULES FOR MUTUAL FUNDS

Background

Over 30 million U.S. households—about one in three families—now own an aggregate of approximately $2.7 trillion in mutual fund assets. In the last year alone, mutual funds assets grew by $700 billion. Just ten years ago, the entire mutual fund industry assets added up to about $700 billion.[5]

Despite the enormous growth in mutual funds, the law governing mutual fund regulation has remained virtually untouched for over 25 years. S. 1815 amends the Investment Company Act of 1940 and amends the Securities Act of 1933 to facilitate the registration and operation of mutual funds.

Registration of mutual funds

Currently, a mutual fund must register its shares with the SEC and comply with registration requirements in each of the fifty states where it wishes to publicly offer its securities. Although there is some similarity among state's registration requirements, according to the Investment Company Industry's testimony before the Committee, the fifty states still require up to sixteen different approaches to regulation.[6] For example, some states comment on the mutual fund prospectus and limit the types of investments certain funds may make. Other states require registration, conduct a "merit review" of the offering, or offer an exemption from registration. This "crazy quilt" of regulation has made registration of mutual fund shares unnecessarily cumbersome—in some cases leading mutual funds to restrict their fund offerings to residents of certain states.

The Committee believes that it is appropriate to provide for exclusive federal review of mutual fund—and other investment company—registration. Exclusive federal review of investment company registration would significantly benefit mutual funds and investors. State regulation frequently poses significant obstacles to investment companies even though they engage in business on a national scale and are constantly in registration. In addition, the SEC already comprehensively regulates investment companies under the disclosure provisions of the Securities Act and the substantive regulatory provisions of the Investment Company Act.

The legislation approved by the Committee provides for states to continue carrying out their important role of policing fraud in connection with investment company offerings. The states will also continue to collect registration or "appropriate" fees that may be used to augment existing antifraud programs. The Committee also preserves states' authority to regulate broker-dealer conduct whether or not the offering is preempted from state review. In preserving this authority, however, the Committee expects the states only to police conduct—not to use this authority as justification to continue reviewing investment company registration statements or prospectuses.

The Committee does not intend for the "policing" authority to provide states with a means to undo the state preemption of investment company registration. However, the Committee believes that allowing states to continue overseeing broker-dealer conduct in con-

[5] "From Security to Self-Reliance: American Investors in the 1990's," Remarks by Arthur Levitt, Chairman of the Securities and Exchange Commission, to the Investment Company Institute in Washington, D.C., May 22, 1996.

[6] Prepared statement of Matthew P. Fink, President, investment Company Institute, before the Committee on Banking, Housing, and Urban Affairs on S. 1815, the "Securities Investment Promotion Act of 1996" at Appendix A, p. 3.

nection with preempted offerings will maintain added investor protection. The Committee does not intend to alter state statutory or common law with respect to fraud or deceit, including broker-dealer sales practices, in connection with securities or securities transactions.

Modernizing mutual fund regulation

The Committee's legislation also updates certain aspects of mutual fund regulation. It permits a mutual fund to invest in other mutual funds in its "family," simplifies the way mutual funds register and pay registration fees, enables mutual funds to include current information in their advertisements without cluttering up the initial prospectus, and prohibits potentially misleading fund names.

"Fund of funds"

In 1970, the Investment Company Act was amended to restrict fund of funds arrangements—where one investment company invests in another investment company—in response to concerns at that time that these types of arrangements resulted in excessive layering of fees and abuses of control arising from the concentration of voting power in the acquiring fund.

A new type of fund of funds, involving a fund that invests in other funds in the same group or "family" of funds, has become a popular way for investors to diversify a fund investment through a single, professionally managed portfolio. The SEC has granted individual exemptions from the Investment Company Act's restrictions to several similar fund of funds arrangements, subject to certain conditions that address the concerns underlying the statutory restrictions (such as overly complex corporate structures and excessive distribution fees). S.1815 enables fund of funds arrangements involving a group of investment companies to be offered without obtaining prior exemptive relief from the Commission. The bill also gives the SEC authority to adopt rules to fill any gaps in investor protection or to address any abuses arising in connection with this new fund-of-funds exemption.

Flexible registration of securities

Mutual funds and certain other types of investment companies sell and redeem their shares on a continuous basis. Right now, mutual funds may pay registration fees required by the Securities Act based on net sales less redemptions. If certain filing deadlines are not met, however, mutual funds face serious penalties. If a mutual fund pays its registration fees more than 60 days late, the fund may not "net" its sales against its redemptions—resulting in significantly higher registration fees. If a mutual fund fails to pay its registration fees within 180 days, the fund may be deemed to have sold unregistered securities—possibly allowing shareholders to rescind their transactions. This payment system unduly punishes late filings and the penalties do not further investor protection. Accordingly, the bill implements a new, simpler system for the payment of registration fees, with an incentive to file and pay fees promptly. This system ensures that mutual funds will not be deemed to have sold unregistered securities or lose the ability to net redemptions against sales simply because the registration fee was paid late. Instead, S. 1815 encourages timely filing and payment by requiring mutual funds that file late to pay interest on the amount due to the U.S. Treasury.

The bill accommodates concerns expressed by the SEC by extending the effective date for this provision to the earlier of one year or the conclusion of SEC rulemaking. This extension should be a sufficient amount of time for the Commission to review its rules and reprogram its systems to accommodate the changes.

Facilitating mutual fund advertising

Mutual funds continuously offer and sell their shares to the public—making advertising a critical part of their operations. Like other public issuers of securities, funds must comply with the advertising requirements of the Securities Act. However, the Securities Act regulatory scheme has proven to be an inappropriate fit for fund advertising.

Currently, funds may advertise performance data and other information, so long as the "substance of" that information is contained in the fund's prospectus. As a result, funds often clutter up their prospectuses with information they may later want to include in advertisements. For example, funds could not advertise matters of investor interest, including whether it will hold derivatives or the effect of economic conditions on the fund's investment policies, without having included this information in the fund's prospectus.

The bill improves fund advertising by giving the Commission express authority to create a new investment company "advertising prospectus." Funds would be able to use an advertising prospectus to show performance data and other information unrestricted by the "substance of" requirement. The Committee believes the benefits to investors from this change will be twofold. First, it will encourage shorter, more "investor-friendly" disclosure documents. Second, it will increase the amount of timely information about a fund.

The advertising prospectus would be subject to the liability provisions of the Securities Act applicable to prospectuses.

Prohibiting deceptive or misleading investment company names

When making an investment decision, investors may focus on fund names to determine the fund's investment objective and level of risk. For example, investors may believe that a mutual fund name that includes "government," "guaranteed," or "insured" means their investments are guaranteed by state or federal governmental authorities.

The Investment Company Act currently prohibits funds from using misleading or deceptive names. Enforcing the Act entails a cumbersome process—the Commission must first find, and declare by order, that a fund's name is deceptive or misleading, and then bring an action in federal court to enjoin use of the name. The Committee believes that investor protection merits a more streamlined approach to making sure mutual funds do not name their funds in a misleading manner. S.1815 authorizes the SEC to address these practices by rule. The SEC may define by rule names that it finds are "materially deceptive or misleading."

This provision should not be construed to be a bar against common or similar names between a registered investment company and an affiliate organization, such as an insured bank.

Additional investor protections: improving books and records and shareholder reporting

Although the Investment Company Act requires mutual funds to maintain certain books and records and to report current information to shareholders, the Committee believes the SEC needs additional authority to strengthen those requirements, consistent with investor protection. Additional flexibility would also allow the SEC to adapt its examination program and shareholder reporting requirements to account for changes in the marketplace.

Currently, the SEC can only require mutual funds to maintain records relating to the fund's financial statements. The SEC is further limited in its inspection program since it only has the authority to inspect the records mutual funds are required to maintain. S. 1815 enables the SEC to specify, by rule, the information that must be included in investment company records. The bill gives the SEC significant authority to enhance its inspection program—the SEC will have the ability both to require more record keeping and to inspect those records. The bill uses the same definition of "records" that broker-dealers must currently maintain to create a more uniform standard of record keeping in the securities industry.

The bill approved by the Committee also expands the SEC's authority to prescribe the contents of semi-annual reports to shareholders. Right now, the SEC may only dictate the contents of a mutual fund's financial statements. Under the newly expanded authority, the SEC may also require that mutual funds provide more than semi-annual or quarterly reporting. Specifically, the SEC may require a fund to file information, documents and reports "to keep reasonably current the information and documents contained in the registration statement."

While the Committee believes that the record keeping and shareholder reporting provisions will improve investor protection and enhance investor confidence, the Committee does not intend to unduly burden investment companies with unnecessary regulation. Accordingly, the bill requires the SEC to balance investor protection concerns with compliance burdens on investment companies to minimize the impact of added regulation. All things being equal, however, the Committee expects the SEC to take appropriate action to ensure investor protection.

Expanding "private" investment pools

The Investment Company Act generally excepts from the Investment Company Act's regulation any issuer that has no more than 100 investors and does not publicly offer its securities. There is no requirement that any of those 100 investors meet any test of net worth or financial sophistication.[7]

[7] The Senate passed the "Small Business Incentive Act" (S. 479), which contained a similar "qualified purchaser" provision, on November 2, 1993.

The Committee recognizes the important role that these pools can play in facilitating capital formation for U.S. companies—particularly new ventures or companies in emerging industries. Regulatory restrictions on these private pools have caused some Americans to invest in unregulated offshore markets. The bill expands capital formation opportunities by creating a new exception from registration and regulation under the Investment Company Act for private investment pools. These private pools ("qualified purchaser pools") could consist of an unlimited number of highly sophisticated shareholders who are "qualified purchasers," so long as the pool does not publicly offer its securities.

The qualified purchaser pool reflects the Committee's recognition that financially sophisticated investors are in a position to appreciate the risks associated with investment pools that do not have the Investment Company Act's protections. Generally, these investors can evaluate on their own behalf matters such as the level of a fund's management fees, governance provisions, transactions with affiliates, investment risk, leverage, and redemption rights.

A "qualified purchaser" refers to (1) any natural person (including spouses when the investments are owned jointly) who owns at least $5 million in "investments," as defined by the SEC; (2) any other person (such as an institutional investor) that owns and manages on a discretionary basis at least $25 million in investments; and (3) any other person the SEC determines by rulemaking does not need the protections of the Investment Company Act.

In defining any new class of qualified purchasers by rule, the Commission should consider, among other things, factors such as the participants' net worth, knowledge and experience in financial matters, and amount of assets owned or under management. The Committee intends the SEC to deem as qualified purchasers only those persons the SEC determines may fend for themselves without the protection of the Investment Company Act.

The bill defers to the SEC to define what constitutes an "investment" for purposes of meeting the $5 million and $25 million thresholds. The Committee expects, however, that the SEC would define "investments" to include assets held for investment purposes. The Committee does not anticipate or recommend the inclusion, for example, of a controlling interest in a privately-owned family business or a personal residence.

The legislation also recognizes certain family investment vehicles—family trusts and other types of companies—as qualified purchasers under certain circumstances. A "company" that has $5 million in assets and that is owned by an extended family would be considered a qualified purchaser.

Only qualified purchasers may purchase interests in a qualified purchaser pool for their account or the account of other qualified purchasers. An investment adviser managing private accounts would not be permitted to purchase interests in a qualified purchaser pool on behalf of a client unless that client is also a qualified purchaser.

As a general rule, qualified purchasers may not purchase an interest in a qualified purchaser pool solely to transfer the interest to one or more nonqualified purchasers. The Committee acknowledges at least two situations where qualified purchaser pool interests may legitimately be transferred. First, interests in a qualified purchaser pool received through a gift, bequest or other involuntary action are deemed to be made to qualified purchasers—even if the recipient does not otherwise meet the definition of qualified purchaser. Second, trusts in which only qualified purchasers have contributed assets are also deemed to be qualified purchasers.

Commodity Pools and Commodity Trading Advisers

The Committee has not included a provision addressing the need for exemptive relief under the Investment Company Act and the Investment Advisers Act for commodity pools and commodity trading advisers.[8] The Committee understands, however, that limited relief exists but has shown to be unduly restrictive. The SEC staff has indicated a willingness to consider and take action to give commodity pools and commodity trading advisers further administrative relief. The Committee expects the SEC staff to consider and, where appropriate, to take action to effect such administrative relief as soon as practicable following enactment of this legislation.

Performance fees

The Investment Advisers Act generally prohibits a registered investment adviser from receiving compensation on the basis of a share of capital gains in or capital appreciation of a client's account. Commonly referred to as performance-based compensation or a "performance fee," this type of compensation arrangement can take various forms. For example, a fee equaling 10% of an account's gains or a fee of 20% of all the gains in an account exceeding the performance of a designated securities index or other bench mark would be a performance fee.

Originally, performance fees were prohibited out of concern that they created incentives for advisers to take undue risks in managing a client's account in order to increase advisory fees. In 1970, Congress concluded that performance fees were not necessarily undesirable in all cases and exempted from the performance fee prohibition a type of fee known as a "fulcrum fee." Investment advisers may enter into fulcrum fee arrangements with registered investment companies or persons with at least $1 million in assets. Commission rules also provide a limited exemption from the prohibition for advisory contracts with clients having at least $500,000 under management or a net worth exceeding $1 million.

The Committee believes that investors in a qualified purchaser pool are sophisticated enough to be allowed to enter into a fee arrangement that is not a fulcrum fee. In addition, advisers should be permitted to enter into performance fee contracts with their foreign clients when such arrangements are legal and customary in a client's country of residence. S. 1815 eliminates the competitive disadvantage experienced by U.S. investment advisers by allowing them to enter into customary performance fee arrangements with foreign clients. The bill also gives the SEC greater flexibility to exempt from the performance fee prohibition advisory contracts with

[8] Generally, "commodity pools" refer to issuers that primarily engaged in the business of operating a commodity pool or investing in interests of such pools and "commodity adviser" refers to those individuals who trade or give trading advice on commodity interests.

institutional clients that can appreciate the risks and are in a position to protect themselves from overreaching by the adviser.

OPENING THE CAPITAL MARKETS FOR SMALL BUSINESS

The "Small Business Incentive Act"

The Committee believes that small business is the engine of economic growth and remains interested in finding ways to open up the capital markets to small business. The provisions of the bill based on the "Small Business Incentive Act" enhance small business access to credit by making it easier for certain types of companies to raise capital and promote investments in small business. These provisions were considered and passed by the Senate during the 103rd Congress.

Exemption for economic, business and industrial development companies

State-chartered economic, business or industrial development companies that provide capital, investment and managerial assistance to small projects and businesses will no longer have to register with the SEC under the Investment Company Act if they meet two conditions. First, the company must be limited to promoting economic, business, or industrial development in the state in which the company is organized. Second, the company could not issue redeemable securities and must sell at least 80% of its securities to "accredited investors" residing in the state where the company is organized.

The Committee believes these companies perform an important local function—stimulating local economies by providing direct investment and loan financing, as well as managerial assistance, to different types of state and local enterprises—and should be regulated at the state level, not the federal level. States have a strong interest in these companies' operations. To qualify for the proposed exemption, a company would have to be regulated under a specific state statute and organized under the laws of that state.[9] Because some state statutes provide comprehensive regulation, while others are less substantive, the bill authorizes the SEC to supplement state provisions when necessary to respond to investor protection concerns.

Exemption for intrastate closed-end investment company

The Commission currently may exempt an intrastate closed-end fund from some or all of the Investment Company Act's provisions if the aggregate proceeds of completed and proposed offerings do not exceed $100,000. This limit was set in 1940 and never has been changed. To reflect the capital needs of intrastate funds in today's financial market, the bill increases the aggregate offering amount to $10 million or such other amount as the SEC may set by rule or order.

Business Development Companies

Business development companies, or "BDCs," are closed-end funds that invest in small and developing businesses. BDCs differ

[9] Forty-four states now have statutes specifically authorizing the creation of these companies.

significantly from traditional investment companies, in that the Investment Company Act requires BDCs to offer significant managerial assistance to the company in which the BDC invests (the "portfolio company"). The Committee believes that giving BDCs more flexibility will encourage more investment in small businesses.

The SEC regulates BDCs in a manner similar to registered investment companies. BDCs, however, are not required to register with the Commission as investment companies, and generally are permitted greater flexibility in dealing with their portfolio companies, issuing and pricing securities, and compensating management. Originally intended to serve as a public alternative to private venture capital firms, BDCs have drawn only limited public investor interest. In 1993, there were only about 44 active BDCs with assets of about $2.5 billion. In 1995, the number of active BDCs increased to 60, but the assets under management declined to $2.1 billion.

The Committee believes that changing BDC regulation to make it easier and less costly for BDCs to offer securities and to invest in small businesses will make this type of investment vehicle more attractive. S. 1815 creates a new class of portfolio companies in which BDCs may invest without making available "significant managerial assistance," permits BDCs to acquire more freely the securities of portfolio companies, and allows BDCs greater flexibility in their capital structure.

New class of small portfolio companies

The time and expense involved in providing managerial assistance to companies having low levels of total assets and market capitalization may deter BDCs from investing in them. These companies, however, often are most in need of capital. To address this problem, the Committee creates a new class of portfolio companies in which BDCs could invest without making available significant managerial assistance. This new class would include any company that has total assets of $4 million or less and capital and surplus of more than $2 million, and any other company that meets criteria prescribed by SEC rule.

Acquisitions of securities

The bill also permits BDCs to acquire more freely the securities of portfolio companies. Currently, BDCs must monitor their portfolios to assure that at least 70% of their assets are invested in cash, securities of financially troubled businesses, and securities of "eligible portfolio companies." Eligible portfolio companies are companies that the BDC controls or companies whose securities do not qualify for margin listing under Federal Reserve Board regulations. Currently, the securities of portfolio companies that do not qualify for margin listing must be acquired directly from the companies or their affiliated persons. The bill permits BDCs to acquire these securities from any other person, increasing the liquidity of such securities.

Capital structure

The bill approved by the Committee permits BDCs greater flexibility in their capital structure so that BDCs could issue multiple classes of debt securities, without restriction. A BDC currently may issue more than one class of debt only if all of its debt securities are privately held or guaranteed by financial institutions, and the BDC has no intent to distribute publicly any class of debt securities. The bill permits public investors to participate in offerings of multiple classes of debt, facilitating the BDCs capital raising process.

The bill also eases restrictions on a BDC's ability to issue warrants, options, or rights. BDCs may now issue only: (1) short-term warrants, options, or rights to their security holders, or (2) warrants, options, or rights that expire within ten years that are accompanied by debt securities. The bill permits BDCs to issue warrants, options, or rights that expire within ten years if they are accompanied by any other securities issued by the BDC and long-term warrants, options, or rights on a stand-alone basis, subject to certain conditions.

To make sure investors are aware of any additional risks associated with these changes to the BDCs capital structure, the legislation authorizes the SEC to require BDCs to supply shareholders with an annual written statement describing the risk factors associated with their capital structures.

STREAMLINING SECURITIES REGULATION TO REFLECT THE CHANGING MARKETPLACE

Background

The U.S. securities market are the preeminent capital markets in the world. In 1995, the U.S. equity market accounted for nearly half of the worldwide equity market, or $7.98 trillion of the total $16.48 trillion. In less than a decade, the trading volume of U.S. markets increased 168% from 77.3 billion shares to 207.4 billion. The market has also become increasingly global in the last ten years—U.S. trading in foreign stocks increased 622%, from $100.2 billion to $723.6 billion, and foreign trading in U.S. stocks expanded 216% from $277.5 billion to $877.6 billion.[10]

Facilitating registration of securities

The securities registration structure in the United States is one of dual Federal and state regulation. In fact, state registration of securities predates the Securities Act of 1933. Most states presently exempt from state review certain securities offerings that are registered with the SEC and do not require state regulatory oversight. In particular, states have exempted from their "blue sky" regulation securities traded on the New York Stock Exchange, the American Stock Exchange and the National Market System of Nasdaq. The bill codifies these exemptions and gives the SEC authority to expand the exemption for securities traded on exchanges that have "substantially similar" listing standards. This flexibility reflects the Committee's desire to include in the preemption future securities exchanges or trading systems provided their listing standards are comparable to those of the exchanges and Nasdaq's National Market System.

[10] U.S. Securities and Exchange Commission, Budget Estimate, Fiscal 1997, at III–3.

The bill also codifies another exemption existing in most states—the preemption from state "blue sky" registration for offers and sales to qualified purchasers. Based on their level of wealth and sophistication, investors who come within the definition of "qualified purchasers" do not require the protections of registration. The bill creates a uniform standard among the states for the "qualified purchaser" exemption.

For both the "blue chip" stock and "qualified purchaser" registrations, the legislation does not create a new category of exempt offerings. Instead, S. 1815 makes uniform existing preemptions by adopting a single standard.

In both cases, the bill preserves state fraud authority. This preservation of authority makes clear that states would continue their role in regulating broker-dealer conduct whether or not the offering is subject to state review. The Committee believes that allowing the states to oversee broker-dealer conduct in connection with preempted offerings will ensure continued investor protection. As long as states continue to police fraud in these offerings, compliance at the federal level will adequately protect investors. In preserving this authority, however, the Committee expects the states only to police conduct—not to use this authority as justification to continue reviewing exempted registration statements or prospectuses. The Committee clearly does not intend for the "policing" authority to provide states with a means to undo the state registration preemptions. States will continue to receive notice filings and fees as specified to facilitate their antifraud efforts.

This provision does not address federal preemption of state registration requirements for certain securities offerings or securities transactions currently exempt from SEC registration under Sections 3(a) and 4 of the Securities Act (for example U.S. government and agency securities, bank securities or private placements). The Committee does not intend to suggest, direct or encourage the states to regulate these offerings and transactions simply because the Committee did not preempt these securities from state registration requirements.

Regulatory flexibility

The Committee recognizes that the rapidly changing marketplace dictates that effective regulation requires a certain amount of flexibility. Accordingly, the bill grants the SEC general exemptive authority under both the Securities Act and the Securities Exchange Act. This exemptive authority will allow the Commission the flexibility to explore and adopt new approaches to registration and disclosure. It will also enable the Commission to address issues related to the securities markets more generally. For example, the SEC could deal with the regulatory concerns raised by the recent proliferation of electronic trading systems, which do not fit neatly into the existing regulatory framework. The exemptive authority would make it easier for the Commission to implement certain proposals to facilitate capital formation, such as the pending "test-the-waters" proposal to assist small businesses or the "company registration" proposal to assist large businesses.

In addition to this general grant of exemptive authority, the Committee had originally planned to include a provision specifically raising the SEC's authority to exempt transactions under Section 3(b) of the Securities Act from $5 million to $10 million. The Committee did not include the provision, however, because of concerns that it would confuse the extent of the SEC's ability to grant exemptions under the general exemptive authority. Further, the Committee did not want to constrain unduly the SEC if the Commission determined that the Section 3(b) exemptive level should be raised higher than $10 million. Although the Committee did not raise the Section 3(b) level, the Committee expects the SEC to increase the exemption amount as soon as practicable.

The Committee is particularly concerned about the ability of certain companies to continue offering employee stock options or fund employee benefit plans under Section 3(a)(2) of the Securities Act and Regulation F (Rule 701). The $5 million cap under Rule 701 has not been adjusted since 1988. Many small, employee owned companies rely on company stock compensation to attract and retain qualified employees. Accordingly, the Committee requests that the SEC examine and resolve this issue as soon as possible after enactment of this legislation.

Analysis of economic effects of regulation

The impact of SEC rulemaking on savings, investment, and capital formation in the nation cannot be overestimated. Although the SEC may be mindful of its impact on the economy, the Committee believes that the SEC should provide to the public an assessment of the economic impact of its regulations and actions. The SEC should consider the benefit of additional regulation with the impact of that regulation on the economy, the markets, and market participants. As a result, the bill strengthens the role of economic analysis in the Commission's deliberations in two ways.

First, the bill authorizes $6 million in annual appropriations for the SEC's Economic Analysis Program. This funding would particularly apply to the Office of Economic Analysis, but it could also embrace funding for economic analysis activities in other offices and for other activities of the Commission. The Committee notes that, at current funding levels, this authorization would still comprise only 2% of the SEC's entire budget, but that represents a significant improvement from the $3 million appropriated for the Office of Economic Analysis in fiscal year 1996.[11]

Second, the bill requires that the SEC's Chief Economist prepare an economic analysis report on each proposed regulation of the Commission. This report would be provided to each Commissioner and published in the Federal Register before the proposed regulation became effective. The Committee hopes that this report will demonstrate serious economic analysis throughout the process of developing regulations.

Eliminating duplicative examinations

Duplicative and overlapping examinations impose unnecessary burdens on broker-dealers and inefficiently use regulatory resources. The SEC and the self-regulatory organizations (SRO's)

[11] It should be noted that this is not an authorization for an add-on to SEC funding, but rather an earmarking of funds within the SEC budget. At current staff levels, the Office of Economic Analysis may reach twenty-two by the end of the current fiscal year.

have begun working to encourage cooperation in scheduling examinations. The Committee strongly supports efforts to eliminate duplication in broker-dealer oversight and provides statutory support to further strengthen these efforts. The bill provides a mandate for better coordination, and a specific authorization for the sharing of information necessary to accomplish this goal.

Access to foreign business information

Current U.S. securities laws governing offshore offerings and tender offers involving a foreign issuer are often interpreted to exclude journalists who disseminate information in the U.S. Foreign issuers involved in non-U.S. offerings, who are generally exempt from having to register under U.S. law are concerned about losing their exemption by having U.S. press included in a press conference about the non-U.S. offering or tender offer.

The bill resolves this unintended consequence by clarifying that a company may hold an offshore press conference or public meeting and provide press-related materials to journalists who disseminate information in the U.S. without triggering U.S. registration or tender offer requirements. The Committee intends to enhance market transparency and ensure that U.S. investors have access to important financial information. The Committee does not intend, in any way, to affect or impact any antifraud provision, including those antifraud provisions that may apply to statements made or materials provided at non U.S. press conferences.

Church employee pension plans

According to testimony provided to the Committee, "[m]ost major religious denominations in the United States have established retirement programs for their clergy and lay workers." [12] Unlike private sector and government retirement plans, however, church employee pension plans are not exempted from securities law registration. While the SEC staff has indicated to the Committee that the SEC does not regard church employee pension plans to be the type of entity that should be subject to the Investment Company Act, there is no express statutory exemption for these plans.

The bill puts church pension plans in the same category as private sector and government plans by exempting church plans from federal and state securities regulation and registration. In order to qualify for the exemption, the assets of the church pension plan must be used exclusively for the benefit of plan participants and beneficiaries.

To protect plan participants and beneficiaries, the Committee opted to tailor very specific exemptions from current law. "Substantially all" of the activities of an exempt company or account must relate to the church plan or its administration. In addition, church plans must meet eligibility requirements under section 414(e) of the Internal Revenue Code and be administered for the exclusive benefit of participants and beneficiaries. The antifraud laws continue to apply to the plan and those individuals who perform cer-

[12] Testimony of Barbara A. Boigegrain, General Board of Pension and Health Benefits of the United Methodist Church and Dr. Paul W. Powell, Annuity Board of the Southern Baptist Convention, on behalf of the Church Alliance, before the Committee on Banking, Housing, and Urban Affairs, p. 2.

tain functions for the plan (who would otherwise have had to register as an investment adviser or broker-dealer), notwithstanding the exemption.

The bill requires church plans to notify plan participants that the plan is not subject to and the participant not covered by state and federal securities laws. The bill also enables the SEC to monitor compliance with the new exemptions by giving the SEC rulemaking authority to require that exempt church plans file a notice with the Commission.

Promoting global preeminence of the U.S. securities market

Mindful of the increasing internationalization of the securities markets, the Committee seeks to ensure that the SEC is working to develop a quality set of generally accepted international accounting standards to facilitate international offerings. The Committee believes that the U.S. should play an active role in developing international accounting standards that will enhance foreign issuers' access to our markets while maintaining adequate investor protections. The Committee acknowledges the SEC's progress to date on working towards a global marketplace and encourages the SEC to continue its vigorous support for developing international accounting standards as soon as practicable. Within one year, the SEC must report on: (1) the progress of developing international accounting standards, and (2) the outlook for successfully completing a set of standards acceptable to the SEC for offerings and listings by foreign issuers in United States markets.

Broker-dealer "de minimis" exemption

Presently, many states require securities brokers to register based on where the investor is located at the time the investor initiates a securities transaction. The Chairman of the Securities Industry Association testified before the Committee that some states require brokers to register if their clients place an order while temporarily in the state—even if the customer just happens to be in the state because of work or vacation.[13] The penalties for failing to register can be onerous. The Uniform Securities Act considers it a criminal offense for a broker-dealer or its employees to fail to comply with state registration requirements. In some cases a customer may rescind a transaction based on a technical nonregistration.

The Committee believes that the states play a critical role with respect to broker-dealer and broker-dealer associated person registration. However, there should be room for some flexibility such as for situations involving a vacationing client. The bill provides limited flexibility to accommodate a broker-dealer associated person in two situations.[14] The first permits an associated person to execute a transaction for a client who is away from home for a period of time as long as the associated person is registered in the state in which the client permanently resides or was present for 30 days or more during the previous year. If the client is present in another State for 30 days or more or permanently changes his or

[13] Testimony of A.B. Krongard, Chairman of the Securities Industry Association, before the Senate Committee on Banking, Housing, and Urban Affairs, p. 9.

[14] In both situations, the broker-dealer must be registered in the state the transaction occurs and the transaction must be executed by the associated person on behalf of an existing client.

her residence, the associated person must file an application for registration.[15]

The second permits an associated person to execute a transaction for an existing customer during the pendency of the associated person's registration in another state. The associated person may only effect transactions in the state where his or her registration application is pending until the earlier of 60 days after the application was filed or the date the State notifies the applicant that registration has been denied or stayed for cause.

SEC studies and reports

Impact of technological advances

The Committee understands that the Internet already has the potential to provide business (including banks and securities firms) with access to approximately 25 million users of online services. Consumers and investors can use their personal computers now to access about 37,000 Web sites and services, including analyst research reports, stock market data, brokerage firm and mutual fund products, prospectuses and other SEC filings—not to mention other new and innovative financial products and services. For example, a number of entrepreneurs are creating Web pages that enable investors to purchase directly from small issuers. Some commentators say that these new electronic networks could lead to small scale "virtual" stock exchanges and become a major source of funding for smaller entities. The Committee believes that the SEC should study the Internet and the World Wide Web and its impact on regulation of the financial services industry. The bill therefore seeks the SEC's views on how to adjust the traditional approach to regulating the securities market to address fundamental changes in the marketplace brought about by technological innovation.

Shareholder proposals

In 1992, the staff of the Securities and Exchange Commission reversed long-standing Commission policy by allowing corporations to exclude from proxy statements shareholder proposals regarding corporate employment practices,[16] even if those practices raised broader public policy issues (such as discriminatory actions by the corporation.) This change generated enormous controversy, and the Commission soon found itself involved in lengthy litigation with a coalition of shareholder groups, including several large institutional investors, who strongly objected to the Commission's abrupt change of policy and the fact that the SEC changed its position without a formal rulemaking. Although the Commission lost a Federal District Court ruling,[17] the SEC's "process" for changing the rule was upheld by the Second Circuit Court of Appeals.[18]

Despite the significant implications of the Commission's policy reversal in 1992—and the subsequent legal decisions—the Commit-

[15] If either of those events occur, the associated person must file an application for registration within 10 days of discovering that the client permanently changed its residence or was in another state for more than 30 days.

[16] The SEC announced in a 1992 "no-action" letter on a resolution to Cracker Barrel that it would regard employment-related shareholder proposals as "ordinary business" issues, excludable under section (c)(7) of Rule 14a–8.

[17] *New York City Employees Retirement System,* 843 F. Supp. 858 (1994).

[18] *New York City Employees Retirement System* v. *SEC,* 45 F.3d 7 (1995).

tee notes that there has been no formal study on shareholder proposals. The bill, therefore, directs the Commission to undertake a comprehensive year-long review of shareholder proposals, focusing on whether shareholders should be able to raise through the proxy process concerns about corporate employment practices, or other business practices, that raise broader social and public policy issues, such as discrimination. The bill further directs the Commission to prepare recommendations on how it plans to improve shareholder access to proxy statement through the SEC's rulemaking process.

"Preferencing"

Preferencing refers to a trading method for stock exchanges that may be inconsistent with the concept of a traditional auction market. Preferencing permits a customer's brokerage firm to trade directly with its customers rather than interact with other customer orders. The brokerage firm acts as a dealer with its own customers, capturing the price difference for itself. The Committee has concerns about the impact of preferencing on retail securities customers. Consequently, the bill directs the SEC to determine and report within six months on the impact of preferencing on: (1) the execution price received by retail securities customers whose orders are preferenced; (2) the ability of retail securities customers in all markets to obtain execution of limit orders in preferenced securities; and (3) the cost of preferencing to retail customers.

SECTION-BY-SECTION ANALYSIS OF S. 1815: THE "SECURITIES INVESTMENT PROMOTION ACT OF 1996"

Section 1. Short title; table of contents

Section 1 provides that S. 1815 may be cited as the "Securities Investment Promotion Act of 1996" (the "Act") and sets out a table of contents for the Act.

Section 2. Severability

Section 2 provides that, if some part of the Act is held to be unconstitutional, the remainder of the Act will not be affected.

TITLE I—INVESTMENT ADVISERS SUPERVISION COORDINATION ACT

Section 101. Short title

Section 101 provides that Title I may be cited as the "Investment Advisers Supervision Coordination Act."

Section 102. Funding for enhanced enforcement priority

Section 102 authorizes up to $16 million of the SEC's budget for fiscal years 1997 and 1998 to be earmarked for enforcement of the Investment Advisers Act of 1940.

Section 103. Improved supervision through State and Federal cooperation

Section 103(a) adds a new section 203A to the Investment Advisers Act of 1940 (the "Advisers Act") dividing regulatory responsibility for investment advisers between the States and the SEC.

New Section 203A provides that investment advisers who manage $25 million (or a higher amount set by the Commission) or more in client assets or who advise a mutual fund or business development company or whose state does not register investment advisers will have to register with the SEC. Other investment advisers will have to register only with the State in which the adviser maintains its principal place of business. The SEC will continue to regulate investment advisers located in states that do not require investment advisers to register.

This section defines "assets under management" to mean securities portfolios over which the adviser provides "continuous and regular supervisory or management services."

New section 23A(b) prohibits a State from subjecting to State registration, licensing or qualification requirements: (1) SEC registered investment advisers and their "supervised persons," and (2) persons who are specifically excepted from the definition of an investment adviser. A "supervised person" includes an employee or independent contractor of an investment adviser who provide investment advice on behalf of and is supervised by the investment adviser.

New section 23A(b) also permits a State to require investment advisers to file with it documents required to be filed with the SEC or "notice" documents relating to an investment advisers' employees. This section also makes clear that the SEC and the States retain their authority to pursue actions against investment advisers for "fraud or deceit."

New section 23A(c) allows the SEC flexibility to determine that certain investment advisers should be permitted to register with the SEC (even if the adviser does not manage $25 million or more in client assets) if denying SEC registration would be "unfair, a burden on interstate commerce, or otherwise inconsistent with the purposes of this section."

Section 104. Interstate cooperation

Section 104 amends section 222 of the Advisers Act, establishing that states may only enforce books and records and financial responsibility standards, as established the state in which the investment adviser maintains its principal place of business.

Section 105. Disqualification of convicted felons

Section 105 amends section 203(e) of the Advisers Act, allowing the SEC to deny or withdraw the registration of an investment adviser convicted of a felony within the previous ten years.

Section 106. Effective date

This section becomes effective 180 days after enactment of the "Investment Advisers Supervision Coordination Act."

TITLE II—FACILITATING INVESTMENT IN MUTUAL FUNDS

Section 201. Short title

Section 201 provides that Title II may be cited as the "Investment Company Act Amendments of 1996."

Section 202. Fund of funds

Section 202 amends Section 12(d) of the Investment Company Act of 1940 (the "Investment Company Act"), allowing a registered investment company to invest in another registered investment company if they are part of the same group or "family" of investment companies. This section also gives the SEC exemptive authority in this area in the event new fund of funds arrangements develop.

A "group" of investment companies is defined as two or more mutual funds or unit investment trusts that hold themselves out to investors as related companies for investment and investor services.

Section 202 also amends section 12(d) to clarify that, when a fund invests all of its assets in a single acquired fund registered with the Commission, under certain circumstances the acquired fund must solicit the votes from the shareholders of the investing fund.

Section 203. Flexible registration of securities

Section 203 amends section 24(e) of the Investment Company Act, implementing a new system under which mutual funds and certain other types of investment companies would pay registration fees under the Securities Act.

Section 203 requires a fund to pay its registration fees to the Commission within 90 days after the end of its fiscal year based on the net of sales less redemptions for that fiscal year. If a fund missed the filing deadline, it would have to pay interest on the amount due, calculated at the rate established by the Secretary of Treasury under the Debt Collection Act of 1982.

This section becomes effective on the earlier of one year from enactment or the effective date of SEC rulemaking for this provision.

Section 204. Facilitating the use of current information in advertising

Section 204 adds a subsection (g) to section 24 of the Investment Company Act, authorizing the SEC to permit investment companies to use a new type of "advertising" prospectus that includes updated information not contained in the fund's original prospectus for purposes of section 5(b)(1) of the Securities Act.

Section 205. Variable insurance contracts

Section 205 amends sections 26 and 27 of the Investment Company Act, replacing the existing specific limits on the amount, type, and timing of charges that apply to variable insurance contracts. Aggregate charges under variable insurance contracts would have to be "reasonable." This section also gives the SEC rulemaking authority to address any potential abusive practices.

Section 206. Prohibition on deceptive investment company names

Section 206 amends section 35(d) of the Investment Company Act, granting the SEC rulemaking authority to identify investment company names, or the title of the securities they issue as materially deceptive or misleading. The SEC must make a finding that the name or title or any part of the title is deceptive or misleading.

Section 207. Excepted investment companies

Section 207 amends section 3(c) (1) and (2) of the Investment Company Act, creating two new exemptions and modifying an existing exemption from the Act's regulation.

Section 207(a)(3) amends section 3(c)(2) of the Investment Company Act by including in the exemption from the definition of an investment company a person acting as a "market intermediary" in certain financial transactions. This section defines market intermediary as a person who regularly does and is willing contemporaneously to enter into transactions on both sides of the market for financial contracts.

"Financial contracts" include transactions involving securities, commodities, currencies, interest or other rates, or other financial or economic interests structured to accommodate the objectives of the counterparty. This section addresses the status of market intermediaries under the Investment Company Act only, and not the status of these entities under any of the other federal securities laws.

Section 207(a)(4) adds a new section (7) to section 3(c) of the Investment Company Act, creating a new exemption from the definition of investment company for investment pools whose securities are held exclusively by "qualified purchasers," as defined under new section 2(a)(51). New section 3(c)(7)(A) provides for a "private" investment pool that may not publicly offer its securities and that may have an unlimited number of "qualified investors." In the event a qualified purchaser transfers securities of a section 3(c)(7) fund as a gift or bequest or due to an involuntary event, such as divorce or death, the transferee shall be deemed to be a "qualified purchaser."

New section 3(c)(7)(B) provides a "grandfather clause" for existing section 3(c)(1) funds (which are limited to 100 investors). The grandfather clause enables existing 3(c)(1) funds to convert to 3(c)(7) funds, retaining existing investors who are not "qualified purchasers." To be eligible to transfer from a section 3(c)(1) to 3(c)(7) fund, the section 3(c)(1) fund shareholders must have acquired the securities of the fund on or before April 30, 1996 and the issuer of the securities must have come within the section 3(c)(1) exemption. Before a transfer may occur, the issuer must disclose that the fund will be limited to qualified purchasers and no longer have the 100 investor limit.

New section 3(c)(7)(c) requires that the section 3(c)(1) issuer provide "dissenter's rights" to fund investors who do not want to transfer into a section 3(c)(7) fund. The issuer must allow section 3(c)(1) fund owners "of record" to redeem their interests in the fund in either cash or a proportionate share of the fund's assets.

A fund exempt under section 3(c)(1) will not be "integrated" with a fund exempt under 3(c)(7) for purposes of determining whether either fund meets its exemption.

New section 3(c)(7)(D) imposes the investment restrictions of section 12(d)(1) (A)(I) and (B)(I) of the Investment Company Act on all section 3(c)(1) and section 3(c)(7) issuers, but only in connection with the transactions involving securities issued by registered investment companies.

New section 3(c)(7)(E) treats beneficial ownership by a company to be beneficial ownership by one person for purposes of determining the number of investors in a section 3(c)(1) fund, unless the company (I) owns ten percent or more of the voting securities of the section 3(c)(1) issuer, and (ii) is, or but for the exception under section 3(c)(1) or 3(c)(7) would be, an investment company.

Section 207(b) adds new paragraph (51) to section 2(a) of the Investment Company Act, defining the term "qualified purchaser." New section 2(a)(51)(A) creates four categories of persons who are eligible to invest in the qualified purchaser pools based on minimum standards of financial sophistication and gives the Commission authority to define by rule additional categories of qualified purchasers.

New section 2(a)(51) defines a qualified purchaser as follows: (1) section 2(a)(51)(A)(I) includes any natural person who owns $5 million in "investments" and that person's spouse if they invest jointly; (2) section 2(a)(51)(A)(ii) defines a qualified purchaser to include specified family-owned companies with at least $5 million in investments; (3) section 2(a)(51)(A)(iii) includes certain trusts, not formed for the specific purpose of acquiring the securities offered, that are established and funded by qualified purchasers for which investment decisions are made by a qualified purchaser; and (4) section 2(a)(51)(A)(iv) includes any person who in the aggregate owns and invests on a discretionary basis for its own account or for the accounts of other qualified purchasers not less than $25 million in investments.

New section 2(a)(51)(A)(v) allows the SEC to specify by rule additional qualified purchasers who may not meet statutorily defined standards of financial sophistication under sections 2(a)(51)(A)(I) through (iv), but who do not need the protection of the Investment Company Act. This provision outlines some of the factors the SEC should consider in determining who does not need the protections of the Investment Company Act. These factors include the purchaser's high degree of financial sophistication, including extensive knowledge of and experience in financial matters, a substantial amount of assets owned or under management, relationship with an issuer, or such other factors as the Commission determines to be consistent with the purposes of new subparagraph 2(a)(51). New subsection 2(a)(51)(B) gives the Commission the authority to carry out this rulemaking.

New subsection 2(a)(51)(c) excludes an existing private investment fund from the definition of "qualified purchaser" unless all beneficial owners of its securities consent. Consent of all trustees, directors or general partners of a trust or family company serves as consent of the trust or family company and its beneficial owners.

Section 207(c) amends section 3(a)(3) of the Investment Company Act, ensuring that any issuer meeting the definition of investment company under section 3(a)(3) of the Investment Company Act may not avoid the Investment Company Act's regulation by establishing a section 3(c)(7) subsidiary.

Section 207(d)(1) requires the SEC to adopt rules implementing Section 3(c)(1)(B) of the Investment Company Act within 12 months of enactment. Section 207(d)(2) requires the SEC to adopt rules within 180 days of enactment to define the types of investments eligible for consideration in satisfying the $5 and $25 million qualified purchaser investment tests. The Committee expects, however, that the SEC would define "investments" to include assets held for investment purposes. The Committee does not anticipate or recommend the inclusion, for example, of a controlling interest in a privately-owned family business or a personal residence.

Section 207(d)(3) requires the SEC to adopt rules within one year rules permitting knowledgeable employees of an issuer or affiliated person to own securities of a section 3(c)(1) or 3(c)(7) fund.

Section 208. Performance fee exemptions

Section 208 amends section 205 of the Investment Advisers Act, excepting investment advisory contracts with qualified purchaser pools from the Act's prohibition on performance fees. Section 208 also amends section 205 to give the SEC explicit authority to exempt from the performance fee prohibition investment advisory contracts with sophisticated clients and clients that are not residents of the United States.

Section 209. Reports to the Commission and shareholders

Section 209 amends section 30(b)(1) and (c) of the Investment Company Act, granting the SEC authority to require more frequent reporting of current information. Right now, section 30(b)(1) allows the SEC to require investment companies to file information and document "to keep reasonably current the information and documents contained in the registration statement" but no more frequently than semi-annually or quarterly.

This provision removes the limitations on how often the SEC may require information. In exercising this expanded authority, however, the SEC must minimize the compliance burdens on registered investment companies and their affiliates as set out in new section 30(c)(1) of the Investment Company Act.

Section 209 also adds a new subsection (f) to section 30 of the Investment Company Act, allowing the SEC to require investment companies to report additional information in its report to shareholders. This provision expands the SEC's current authority, which extends only to the contents of financial statements. New section 30(f) also requires the SEC to minimize the compliance burdens on registered investment companies and their affiliates as set out in new section 30(c)(1) of the Investment Company Act.

Section 210. Books, records and inspections

Section 210 amends section 31 (a) and (b) and adds a new subsection (c) to the Investment Company Act, expanding the SEC's record keeping authority under that Act. This provision enables the SEC to specify the information that must be included in an investment company's records.

Section 31(a), as amended, authorizes the SEC to require registered investment companies and certain of their related entities to maintain *any* records "necessary or appropriate in the public interest or for the protection of investors." This section references the definition of "records" already contained in section 3(a)(37) of the Securities Exchange Act of 1934 (the "Securities Exchange Act") to ensure that broker-dealers and investment companies will have the same standards of record keeping.

Consistent with the SEC's new authority under section 209 of the "Securities Investment Promotion Act," when exercising its new authority under amended section 31(a), the SEC must minimize the record keeping and compliance burdens on persons required to maintain records as set out in new section 31(a)(2) of the Investment Company Act.

New section 31(b) of the Investment Company Act gives the SEC authority to inspect whatever records it requires investment companies to maintain under amended section 31(a). This provision also authorizes the SEC to request copies of records, eliminating the current requirement that the SEC first obtain a formal order. The SEC must make "reasonable" requests for copies or extracts of records under this section, that may be prepared without "undue effort, expense, or delay."

Section 210 amends section 31 of the Investment Company Act by adding a new subsection (c), providing that the SEC may not be compelled to disclose any internal compliance or audit records, or information contained therein. Of course, the SEC may not, under this provision, withhold information from Congress or pursuant to a U.S. department, agency or court request.

Finally, section 210 amends section 31 of the Investment Company Act by adding a new subsection (d), defining two new terms. "Internal compliance policies and procedures" refers to policies and procedures designed to promote compliance with the Federal securities laws. "Internal compliance and audit record" refers to records prepared pursuant to internal compliance policies and procedures.

TITLE III—REDUCING THE COST OF SAVING AND INVESTMENT

Section 301. Exemption for economic, business, and industrial development companies

Section 301 amends section 6(a) of the Investment Company Act by adding a new paragraph 5(A), creating an exemption for a company whose activities are limited to the promotion of economic, business, or industrial development of enterprises doing business in the state in which the company is organized. Under new section 6(a)(5)(A), an economic, business, or industrial development company could sell its securities only to accredited investors as defined in section 2(15) of the Securities Act of 1933 (the "Securities Act.") Eighty percent of the investors must reside or have substantial business in the state where the company is organized. The company could not issue redeemable securities and would be subject to certain restrictions on the purchase of securities issued by an investment company.

New section 6(a)(5)(B) treats these exempted companies as if they were registered investment companies for purposes of section 9 of the Investment Company Act ("ineligibility of certain affiliated persons and underwriters.") A company relying on the exemption in section 301 must file notification with the SEC under new section 6(a)(5)(c) until the SEC determines such filing is not in the public interest or consistent with the protection of investors under new section 6(a)(5)(D). New section 6(a)(5)(E) provides the SEC flexibility to adjust section 301 by giving the SEC additional rulemaking authority in this area.

Section 302. Intrastate closed-end investment company exemption

Section 302 amends section 6(d)(1) of the Investment Company Act, expanding the SEC's authority to exempt from Investment Company Act regulation closed-end funds that publicly offer their securities solely within a particular state. This provision increases the aggregate offering amount of securities that could be offered under the exemption from $100,000 to $10,000,000.

Section 303. Definition of eligible portfolio company

Section 303 amends section 2(a)(46) of the Investment Company Act, to define a new class of "eligible portfolio company." The amended definition includes a new category of companies that have total assets of $4 million or less and capital and surplus of not less than $2 million. The SEC may adjust these amounts to reflect changes in an accepted index or indicator for small business.

Section 304. Definition of business development company

Section 304 amends section 2(a)(48)(B) of the Investment Company Act, modifying the definition of "business development company" to provide that a business development company does not have to make available significant managerial assistance to any company that falls within the new category of eligible portfolio company created by section 303.

Section 305. Acquisition of assets by business development companies

Section 305 amends section 55(a)(1)(A) of the Investment Company Act, permitting business development companies to purchase the securities of companies that do not qualify for margin listing under Federal Reserve Board regulations, from any person, rather than having to acquire these securities directly from the portfolio company itself or its affiliated persons.

Section 306. Capital structure amendments

Section 306 amends section 61(a) of the Investment Company Act, modifying the current capital structure restrictions on business development companies to permit them to issue more than one class of debt, to issue short-term warrants, options or rights that are accompanied by any other security, and to issue long-term warrants, options or rights on a stand-alone basis.

Section 307. Filing of written statements

Section 307 amends section 64(b)(1) of the Investment Company Act, authorizing the SEC to require business development companies to supply shareholders annually with a written statement describing the risk factors associated with their capital structures.

Section 308. Facilitating national securities markets

Section 308 amends section 18 of the Securities Act, preempting three categories of securities from state securities registration requirements.

New section 18(a) provides that states may not: (1) require registration or qualification of the preempted securities; (2) prohibit, limit or impose any conditions on the use of any offering document, including an SEC filed prospectus; or (3) prohibit, limit or impose any merit-based conditions on the offer or sale of the preempted securities.

Section 308 preempts from state registration all registered investment companies. New section 18(b) enumerates the exceptions to section 18(a)—certain issuers, such as blank check companies or penny stock issuers, or persons associated with the offering who are subject to a statutory disqualification—who are not eligible for the registration exemption provided in this section.

Section 308 also preempts from state registration requirements securities registered under the Securities Act that are: (1) listed on the New York Stock Exchange, the American Stock Exchange, or the National Association of Securities Dealers Automated Quotations ("NASDAQ") National Market System; and (2) categories of securities listed on other exchanges or trading systems with substantially similar listing standards, as determined by the Commission.

Finally, new section 18(c) preempts from state registration requirements securities offered sold only to "qualified purchasers," as defined by the Commission.

The states would still be able to: (1) require notice filings and collect fees with respect to certain securities filings under new section 18(d); and (2) enforce anti-fraud provisions and police broker-dealer conduct under new section 18(e).

Section 309. Exemptive authority

Section 309(a) amends the Securities Act by adding a new section 28 and section 309(b) amends the Securities Exchange Act by adding a new section 36, providing the SEC with grants of general exemptive authority under those Acts. The Securities Act exemptive authority could be exercised by rule or regulation, while the Exchange Act exemptive authority also could be exercised by order. The exemption must be necessary or appropriate in the public interest, and consistent with the protection of investors. Under the Exchange Act order exemptive authority, the Commission must establish procedures under which exemptive orders may be granted, and, in its sole discretion, may decline to entertain an application for an order under the new section.

The SEC's exemptive authority under this section does not extend to any person, security or transaction involving government securities under section 15C of the Securities Exchange Act or from the definitions involving government securities under section 3(a) of that Act.

Section 310. Analysis of economic effects of regulation

Section 310(a) authorizes appropriations of $6 million for each of fiscal years 1997 and 1998 for the Commission's Economic Analysis Program, including the Office of Economic Analysis.

Section 310 (b) requires the SEC's Chief Economist to prepare a report on each regulation proposed by the SEC. The report would include: (a) an analysis of the likely costs of the regulation on the

U.S. economy, particularly the securities markets and the participants in those markets; and (b) the estimated impact of the rule on economic and market behavior, including any impact on market liquidity, the costs of investment, and the financial risks of investment. The SEC must give each of its Commissioners a copy of the Chief Economist's report and have the report printed in the Federal Register before the regulation could become effective.

Section 311. Privatization of EDGAR

Section 311 directs the SEC to submit a report to Congress within 180 days on the SEC's plans for promoting competition and innovation of the Electronic Data Gathering Analysis and Retrieval System, or "EDGAR," through privatization of all or any part of the system.

Section 312. Improving coordination of supervision

Section 312 amends section 17 of the Securities Exchange Act by adding a new subsection (I), requiring the SEC and examining authorities for broker-dealers (defined as registered SROs) to eliminate unnecessary and burdensome duplication in the examination process through coordination and cooperation. This provision directs that the Commission and the examining authorities share information, including non-public regulatory information, as appropriate, to foster a coordinated approach to regulatory oversight of broker-dealers that are subject to examination by more than one SRO.

Section 313. Increased access to foreign business information

Section 313 amends the Securities Act and the Securities Exchange Act, clarifying the status of offshore press conferences and press related materials.

Section 313(a) amends the definition of "offer" (of securities) in section 2(3) of the Securities Act to exclude specifically press conferences held outside of the United States, public meetings with issuer representatives conducted outside of the United States, or press related materials released outside of the United States in which an offshore offering is discussed. This exclusion applies only for purposes of section 5 of the Securities Act.

Section 313(b) amends section 14 of the Securities Exchange Act to provide that a "foreign issuer" engaged in a tender offer may grant United States journalists access to such press contacts and press related materials in connection with the tender offer, without triggering the application of the Williams Act procedural provisions that relate to tender offers or requests or invitations for tender. For purposes of this section, a "foreign issuer" is defined to include any corporation or other organization (1) that is incorporated or organized under the laws of any foreign country; *or* (2) the principal place of business of which is located in a foreign country.

Section 314. Short-form registration

Section 314 requires the SEC to amend the eligibility criteria for short-form securities registration within 180 days of enactment. This provision directs the SEC to include non-voting stock (and such other securities as the Commission shall determine) in the calculation of the minimum market capitalization necessary to qualify to use the form for a primary offering.

Section 315. Church employee pension plans

Section 315 exempts from most federal securities regulation any church employee pension plan described in section 414(e) of the Internal Revenue Code of 1986 (the "Code") if, under the plan, no part of the assets may be diverted to purposes other than the exclusive benefit of employees.

Section 315(a) amends section 3(c) of the Investment Company Act by adding a new paragraph 14, excepting church employee pension plans ("Church Plans") from the registration, reporting and other regulatory requirements of that Act.

Section 315(b) amends section 3(a) of the Securities Act by adding a new paragraph 13, exempting interests in Church Plans from registration under that Act.

Section 315(c) amends section 3 of the Securities Exchange Act to include within the definition of exempted securities (but only for purposes of sections 12, 13, 14 and 16 of the Securities Exchange Act) any securities issued by, or interests in, Church Plans. As a result, Section 315(c) exempts church plans and the person associated with such plans, from the requirements of the Securities Exchange Act that directly impact them. This section also adds a new subsection (f) to section 3 of the Securities Exchange Act, specifically providing that church plans, and the trustees, directors, officers, employees or volunteers for such plans, would not be deemed "broker-dealers" if their only securities activities are on behalf of such plans and they do not receive any commission or other transaction-related compensation. The antifraud provisions of the federal securities laws would continue to apply to interests in church plans.

Section 315(d) amends section 203(b) of the Investment Adviser Act by adding a new paragraph 5, exempting churches, church pension boards, and their internal personnel from registration as investment advisers under the Investment Advisers Act. This section also exempts from regulation any company or account that is established by a person eligible to establish a Church Plan if substantially all of its activities relate to managing the assets of, or providing benefits under, exempt Church Plans.

Section 315(e) amends section 304(a)(4)(A) of the Trust Indenture Act to include the securities exempted from the provisions of the Trust Indenture Act any security issued by, or any interest or participation in, any exempt Church Plan.

Section 315(f) exempts Church plans from certain State securities laws relating to: (1) registration and qualification of securities; (2) investment company registration and regulation; and (3) broker-dealer registration and regulation.

This section establishes certain notice provisions to ensure that plan participants and the SEC are aware of a plan's existence and its exempt status. Section 315(g) amends the Investment Company Act by adding new subsection (g) to section 30, requiring Church plans to notify the exempt plan participants that the plan is not subject to and the participants are not covered by registration, regulation or reporting requirements under the Investment Company

Act, the Investment Adviser Act, the Securities Act, the Securities Exchange Act, or the State securities laws. Section 315(h) adds a new subsection (h) to section 30 of the Investment Company Act, authorizing the SEC to require exempt Church plans to file notice with the SEC as "necessary or appropriate in the public interest or consistent with the protection of investors."

Section 316. Promoting global preeminence of American securities markets

Section 316 expresses the sense of the Congress regarding the increasing internationalization of the securities markets and the importance of establishing a high-quality comprehensive set of generally accepted international accounting standards to facilitate international offerings and enhance the ability of foreign issuers to access and list in United States markets. This section expresses the sense that, in addition to the efforts made to date to respond to this growing internationalization, the SEC should enhance its vigorous support for the development of such accounting standards as soon as practicable and report within one year from the date of enactment on: (1) the progress of developing international accounting standards and, (2) the outlook for successfully completing a set of standards acceptable to the SEC for offerings and listings by foreign issuers in United States markets.

Section 317. Broker-dealer exemption from state law for certain de minimis transactions

Section 317 amends section 15 of the Securities Exchange Act by adding a new subsection (h), exempting from state licensing requirements certain "de minimis" transactions by broker-dealer associated persons.

New section 15(h)(1) provides that, to be eligible for the exemption, a broker-dealer associated person must: (a) not be ineligible to register in the State where the transaction occurs; (b) be registered with at least one state and the National Association of Securities Dealers (the "NASD"); and (c) be associated with a broker-dealer registered with the state where the transaction occurs.

New section 15(h)(2) describes the transactions that an associated person may execute under the "de minimis" exemption. A transaction is "covered" in two instances. The first occurs when an existing customer assigned to an associated person (at least fourteen days before the transaction) is away from home for a period of time. If, however, that customer is present in another State for 30 days or more, or permanently changes residence, the associated person must file an application for registration. The associated person must file the application within 10 days from either the date of the transaction or the date of discovering the customer has been present in another state for more than 30 days or has permanently changed residence.

The second "covered" transaction occurs when the associated person executes a transaction for an existing customer in a state in which the associated person's application for registration is pending. The associated person may only effect transactions for the shorter period of (a) 60 days from the date the application was filed; or (b) until the date the State notifies the associated person that the application has been denied or stayed for cause.

Section 318. Studies and reports

Section 318 requires the SEC to conduct a study and submit a report to Congress on three separate issues.

The first study and report, required by section 318(a), concerns the impact of technological advances on how the securities markets operate and steps taken by the SEC to address those changes. Section 318(a) sets out factors the SEC should consider in formulating the study, such as how the SEC has adapted its enforcement policies and practices with respect to disclosure regulations, intermediaries and exchanges, issuer reporting and its relationship and coordination efforts with national regulatory authorities and State authorities. The SEC must submit its report on this study to Congress within one year of enactment.

The second study and report, required by section 318(b), involves the current status of shareholder access to proxy statements under section 14 of the Securities Exchange Act. Section 318(b) directs the SEC to consider the impact recent statutory, judicial, or regulatory changes have had on shareholders' ability to include in proxy statements proposals relating to corporate practices and social issues. The SEC must submit its report to Congress on this study within one year of enactment.

The third study and report, required by section 318(c), addresses the issue of a trading practice referred to as "preferencing" and the impact of preferencing on investors and the national market system. The SEC must consider how preferencing impacts the execution price of transactions and limit orders and the cost of preferencing to retail customers. Section 318(c) defines "preferencing" as the practice of a broker acting as a dealer on a national securities exchange directing the orders of customers to buy or sell securities to itself for execution under rules that permit the broker to take priority over same-priced orders or quotations entered prior in time. The SEC must submit its report on preferencing to Congress within six months of enactment.

REGULATORY IMPACT STATEMENT

The bill makes several important changes in law that significantly reduce regulatory burdens and associated costs on private individuals and businesses.

Title I of the legislation removes an entire layer of regulation from investment advisers. Under the terms of the legislation, an investment adviser is required to register only with the appropriate state securities regulator or the SEC, but not with both as is currently the case. Moreover, another significant cost borne by investment advisers under current law is the difficulty in complying with differing requirements among the states regarding capital, bonding, and the keeping of books and records. The bill reduces those compliance costs by providing for uniform application of home state requirements in each of these areas.

Title II also contains several provisions that reduces regulatory burden faced by investment companies and their investors. Section 202 makes it easier for investment companies to invest in other investment companies. Section 203 reduces SEC registration costs for investment companies by simplifying their ability to deduct redemptions of their securities from new securities registered. Section 204 clears the way for investment companies to include more up-to-date information in advertising material. Section 205 eliminates onerous fee restrictions on variable insurance contracts, putting in their place the more flexible standard that applies to mutual funds. Section 207 broadens the field of potential investors in private investment companies. Section 208 allows the SEC to make certain limited exemptions from restrictions on performance fees under the Investment Adviser Act of 1934.

Title III contains provisions that reduce regulatory burden in a variety of statutes. Sections 301 through 306 make adjustments to the laws governing business development companies, facilitating their role in providing investment to small businesses. Section 308 reduces regulatory and paperwork burdens on mutual funds by providing for a national uniform standard for registration of their securities, eliminating state registration requirements. By some estimates, this change will save mutual funds and their investors $50 million or more each year in compliance and paperwork costs, while at the same time improving the opportunities for people to invest in mutual funds. Section 308 puts into law the practice of most states to exempt nationally traded securities from state registration. Section 309 grants the SEC broad authority to make exemptions from regulation under the Securities Act of 1933 and the Securities Exchange Act of 1934. Section 310 requires the SEC to conduct an economic analysis of new regulations before they can enter into effect, potentially reducing the impact of future SEC regulations on the economy. Section 312 requires that securities regulators coordinate examination activities, thereby reducing the disruptive effects that examinations can have on business operations. Section 313 serves to eliminate some unintended consequences of provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934, interpretations of which have often led to U.S. press being excluded from foreign business press conferences and briefings. Section 314 makes it easier for some companies to make use of SEC short-form filing procedures. Section 315 exempts church employee pension plans from a variety of securities statutes. Section 317 exempts broker-dealers from state laws for certain de minimis transactions.

While these provisions and the overall effect of the bill would significantly reduce regulatory burden, a few provisions present new regulatory requirements. Section 206 increases SEC supervision of investment company names for the sole express purpose of eliminating deception. All investment companies are currently subject to prohibition of deceptive use of fund names, so the provision does not impose a new standard, but it would allow the SEC to undertake actions through rule-making or otherwise without seeking redress in court. This provision should not impose any routine or general paperwork burdens and should not impose any economic impact.

Section 209 broadens the authority for the SEC to require reports under the Investment Company Act of 1940. The requirement potentially could apply to any or all of the approximately 6,000 investment companies in the United States, with approximately 40 million shareholders. Because this is permissive authority, the Committee is unable to estimate what reporting requirements the SEC might impose or the compliance burden of such regulation, although the provision includes requirements that the authority granted be exercised with the least possible regulatory impact.

Section 210 gives the SEC authority to require the maintenance of certain books and records by investment companies and to make such records available to the SEC for periodic, special, or other examinations. Since investment companies already maintain books and records, there may be little or no paperwork impact from this provision were the SEC to require no addition to the books and records traditionally kept by investment companies. The Committee is unable to estimate the regulatory impact of any additional record-keeping requirements the SEC might impose nor the impact of an inspection program that the Commission might institute, although a regular, periodic inspection program would have a greater regulatory impact than would a program of special or "for-cause" inspections. The Committee notes that the provision includes requirements that the authority granted be exercised with the least possible regulatory impact.

CHANGES IN EXISTING LAW

In the opinion of the Committee, it is necessary to dispense with the requirements of paragraph or subsection 12 of rule XXVI of the Standing Rules of the Senate in order to expedite the business of the Senate.

COST OF LEGISLATION

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, June 26, 1996.

Hon. ALFONSE M. D'AMATO,
Chairman, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for S. 1815, the Securities Investment Promotion Act of 1996.

Enactment of S. 1815 would affect receipts. Therefore, pay-as-you-go procedures would apply to the bill.

If you wish further details on this estimate, we will be pleased to provide them.

Sincerely,

JUNE E. O'NEILL, *Director.*

Enclosure.

CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

1. Bill number: S. 1815.
2. Bill title: Securities Investment Promotion Act of 1996.
3. Bill status: As ordered reported by the Senate Committee on Banking, Housing, and Urban Affairs on June 19, 1996.

4. Bill purpose: S. 1815 would amend federal laws that regulate securities. The bill would streamline the securities markets and decrease the regulation of certain products offered by the capital markets.

Title I of S. 1815 would ease registration and bookkeeping requirements for certain investment advisors. The bill would exempt investment advisors already regulated by a state from registering with the Securities and Exchange Commission (SEC) unless the investment advisor manages assets greater than $25 million or acts as an adviser to an investment or business development company. The bill would restrict the ability of a state to impose certain requirements on investment advisors who conduct business in the state but maintain their principal place of business elsewhere. The bill also would prohibit the SEC from licensing convicted felons as investment advisors.

Title II would amend the Investment Company Act of 1940 to establish rules governing investment companies that wish to offer mutual funds comprised of other mutual funds. In addition, the title would authorize investment companies to include data related to the performance of mutual funds's prospectus and would exempt certain types of investment companies from the securities laws. The bill also would case regulations on the amount of fees that insurance companies can charge to customers who buy variable annuities.

Title II would provide the SEC with more flexibility in determining which records are necessary for the agency to monitor investment companies. The SEC would be required to consider the costs and benefits of requiring additional filings and recordkeeping by the investment companies. Title II also would require the SEC to promulgate rules concerning companies exempted from the Investment Company Act and suitable names for investment company products.

Current law requires investment companies to file a registration statement with the SEC before offering shares of a mutual fund to the public. At the time of registration most mutual funds register an "indefinite" number of shares and pay a $500 regulatory fee. At the end of the company's fiscal year, the firm must pay a registration fee to the SEC based upon the net number of shares sold. S. 1815 would simplify the calculations needed to determine the amount owed to the SEC and would extend the window during which an investment company must pay the registration fee from 60 days to 90 days after the end of its fiscal year.

Title III of S. 1815 would preempt state registration requirements for securities (1) listed on the New York Stock Exchange (NYSE), the American Stock Exchange (AMEX) or the National Association of Securities Dealers Automated Quotation System (NASDAQ), (2) sold to qualified investors, as defined by the SEC in a later rulemaking, or (3) issued by investment companies. The bill would preserve the ability of states to require certain filings and fees and would allow states to pursue instances of fraud. In addition, Title III would:

Modify the Investment Company Act to expand the range of companies in which business development companies may invest, Exempt from most SEC regulation certain business development companies that invest in the state in which they are organized,

Require the SEC to prepare a report analyzing the effect of each proposed regulation on the U.S. economy,

Direct the SEC and other examining authorities to coordinate examinations of brokers and dealers and to eliminate duplication in the examination process,

Exempt church employee pension plans from most of the federal securities laws, and

Require the SEC to conduct studies on the privatization of the Electronic Data Gathering Analysis and Retrieval System (EDGAR), the impact of technological advances on the securities markets, the ability of shareholders to access proxy statements, and the effect of certain trading practices on the national exchanges.

Finally, S. 1815 would authorize appropriations in each of fiscal years 1997 and 1998 of up to $16 million for enforcement of the Investment Advisors Act and $6 million to carry out the Economic Analysis Program.

5. Estimated cost to the Federal Government: CBO estimates that enacting S. 1815 would result in new discretionary spending totaling about $49 million over the 1997–2002 period, assuming appropriations of the necessary amounts. The bill also would reduce governmental receipts by $9 million in fiscal year 1998 and by less than $500,000 in other fiscal years. The estimated budgetary impact of the bill is summarized in the following table.

[By fiscal years, in millions of dollars]

	1997	1998	1999	2000	2001	2002
SPENDING SUBJECT TO APPROPRIATIONS						
Estimated authorization level	23	22	1	1	1	1
Estimated outlays	20	22	4	1	1	1
CHANGES IN REVENUES						
Estimated revenues	[1]	–9	[1]	[1]	[1]	[1]

[1] Less than $500,000

The costs of this bill fall within budget function 370.

6. Basis of estimate:

Spending Subject to appropriations

CBO estimates that enacting S. 1815 would result in additional discretionary spending of about $20 million in fiscal year 1997 and $49 million over the 1997–2002 period, assuming appropriations of the authorized amounts. S. 1815 would specifically authorize appropriations of $22 million in each of fiscal years 1997 and 1998. Those authorizations would cover only a portion of the SEC's responsibilities. For fiscal year 1996, the agency received an appropriation of $103 million.

In addition to the above amounts, CBO estimates that the SEC would spend about $1 million to conduct the rulemakings and studies required by the bill in fiscal year 1997. Further costs would result from the bill's requirement that the SEC prepare a report analyzing the effect of each proposed regulation on the U.S. economy.

Based on information from the agency, CBO estimates that preparation of an estimated 50 reports in each fiscal year would cost the agency about $1 million annually. For fiscal years 1997 and 1998, the cost of preparing such reports would be covered by the authorization of appropriations of $6 million for the Economic Analysis Program. In each of fiscal years 1999 to 2002, CBO estimates additional discretionary spending of $1 million to cover the costs of reports.

Revenues

Investment Advisor's Fee. Under current law, investment advisors are subject to SEC regulations and required to pay a one-time $150 fee to register with the SEC. The SEC estimates that 1,000 to 2,000 investment advisors register each year, for total annual fees of about $225,000. Title I of the bill would exempt investment advisors who manage less than $25 million in client funds from SEC regulation. According to the SEC, about 75 percent of the investment advisors who currently register manage less than $25 million in client funds. Therefore, CBO estimates that enacting Title I of the bill would reduce SEC collections by about $170,000 annually.

Registration Fee. S. 1815 would extend the deadline for investment companies to file registration fees on the net value of mutual funds sold to the public from 60 days to 90 days after the end of a company's fiscal year. CBO estimates that this delay in payments to the SEC would result in a one-time reduction in governmental receipts of about $9 million in fiscal year 1998, because it would shift payments by some companies from fiscal year 1998 into 1999. (CBO estimates that the bill would not affect 1997 receipts because this provision would not take effect until one year after enactment.) Similar shifts would occur in subsequent years. Thus, while total receipts from registration fees would remain largely unchanged, there would be a budgetary effect in 1998.

Because companies filing beyond the deadline are subject to higher fees, extending the filing period also could reduce total fee collections. However, the bill would authorize the SEC to collect interest on late payments, and such interest would partially offset any reduction in the amount of delinquent fees. In addition, the bill would simplify the procedures by which registration fees are calculated: that simplification could increase fee collections through greater compliance. CBO estimates that these provisions taken together would not significantly affect the amount of fees collected by the SEC.

7. Pay-as-you-go considerations: Section 252 of the Balanced Budget and Emergency Deficit Control Act of 1985 sets up pay-as-you-go procedures for legislation affecting direct spending or receipts through 1998. CBO estimates that enactment of S. 1815 would affect receipts by extending the due date for certain registration fees and by reducing the number of investment advisors who must register with the SEC and thus pay the requisite fee. Therefore, pay-as-you-go procedures would apply to the bill. The following table summarizes the estimated pay-as-you-go impact of S. 1815.

[By fiscal years in millions of dollars]

	1996	1997	1998
Change in outlays	[1]	[1]	[1]
Change in receipts	0	0	−9

[1] Not applicable

8. Estimated impact on State, local, and tribal governments: S. 1815 contains mandates on state governments that CBO estimates would impose direct costs that do not exceed the $50 million annual threshold established by the Unfunded Mandates Reform Act of 1995 (Public Law 104–4). Public Law 104–4 defines the direct costs of an intergovernmental mandate as "the aggregate estimated amounts that all state, local, and tribal governments would be required to spend or would be prohibited from raising in revenues in order to comply with the Federal intergovernmental mandate." CBO estimates that the mandate in this bill—particularly the preemption of state requirements for securities listed on the national exchanges and the partial preemption of state registration requirements for securities salespersons—would prohibit states from collecting fees totaling less than $15 million annually that they otherwise would collect.

Preemption of State Requirements for Exchange-Listed Securities. CBO estimates that the bill would lower state fee revenues by about $5 million annually by preempting state registration and filing requirements for securities listed on the NYSE, the AMEX, and the NASDAQ. While most states currently exempt these securities from any state requirements, CBO identified six states that do not. We estimate that revenue losses in those states would total about $5 million annually.

Partial Preemption of State Registration Requirements for Securities Salespersons. The bill would partially preempt state laws to create a uniform exemption from registration for securities salespersons. Because the exemption in the bill is broader than most of the exemptions in current state laws, the bill would likely result in fewer registrations by salespersons and thus a reduction in revenues from associated fees. States' annual registration fees for salespersons currently range from $15 to $235 per agent. CBO estimates that states collect a total of $150 million to $250 million annually from these fees. None of the states we surveyed collect data about the number of transactions that registered salespersons conduct in their states, but based on conversations with state regulators, CBO estimates that state fee collections would decrease by less than $10 million per year. Revenue losses would be concentrated in those states that do not currently have an exemption, especially those that have a large number of seasonal residents.

State enforcement costs could increase as a result of the uniform exemption, but CBO cannot estimate the extent of the increase. A state that does not currently offer an exemption need only prove that a salesperson who is conducting business in the state does not have a license in order to take action against the salesperson. If S. 1815 were enacted into law, however, the state would have to prove that the transactions conducted by the salesperson were not covered by the exclusion.

Preemption of State Registration Requirements for Securities. The bill would preempt state laws requiring the registration or qualification of certain categories of securities and certain securities transactions. The bill provides, however, that states may require the filing of documents filed with the SEC together with any required fee. It further provides that states may continue to collect filing or registration fees pursuant to state laws in effect prior to the enactment of S. 1815. CBO estimates that these fees currently generate revenues for the states totaling $210 million to $240 million annually, and that this bill would not preclude the collection of such fees.

There is, however, some uncertainty as to whether these fee collections would continue uninterrupted in all states if S. 1815 is enacted. The North American Securities Administrators Association (NASAA) and several state securities regulators have expressed concern that if S. 1815 were enacted some states, because of the construction of their own statutes, would not be above to withstand legal challenges to their right to collect current fees. However, CBO believes that because the scope of the federal preemption in S. 1815 is limited, any loss of revenues would not be a direct cost of a federal mandate as defined in Public Law 104–4.

By prohibiting states from registering investment company offerings or reviewing disclosure documents, the bill would produce administrative savings for those states that currently devote staff resources to those tasks. In our survey of state securities regulators, however, CBO found that only about a dozen states actively review and comment on disclosure documents, and that only a few staff members in each state were assigned to those tasks. Therefore, we estimate that the administrative savings to states would not significantly offset revenue losses from other mandates in the bill.

Partial Preemption of State Requirements for Investment Advisers. S. 1815 would partially preempt state laws requiring the registration, licensing, or qualification of investment adviser firms and their employees. Firms that manage more than $25 million in client assets or who advise an investment company or business development company would have to register with the SEC but would be exempt from similar state requirements. These firms' employees or independent contractors would also be exempt from state registration, licensing, and qualification requirements. According to NASAA, 46 states currently register investment adviser firms and 30 states license or register these firms' employees.

As with registration fees for securities, the bill provides that states may require the filing of documents filed with the SEC together with any required fee, and further provides that states may continue to collect filing or registration fees pursuant to state laws in effect prior to the enactment of S. 1815. There is some uncertainty as to whether these fee collections would continue uninterrupted in all states if S. 1815 is enacted. Again, CBO believes that because the scope of this federal preemption is limited, any loss of revenues would not be a direct cost of a federal mandate as defined in Public Law 104–4.

9. Estimated impact on the private sector: CBO has identified four private-sector mandates in this bill. We expect that these mandates would not impose any significant costs on the private

sector. One mandate would impose requirements on examining authorities, also referred to as self-regulating organizations (SROs), such as the New York Stock Exchange and the American Stock Exchange, while the remaining three would impose requirements on investment advisors, investment companies, and certain related entities.

To eliminate duplicate and overlapping examinations, the first mandate would require that the SROs and the SEC coordinate the examination process for the brokers and dealers that are subject to more than one examining authority. Based on information provided by the SEC and the SROs, CBO concludes that the SROs would not incur any additional costs because they are already coordinating the examination process with the SEC.

The other mandates affect larger investment advisors, investment companies, and certain related entities. The bill would allow the SEC to require larger investment advisors to file fees, applications, reports or notices through a SEC-designated entity. Based on information from the SEC and industry representatives, CBO concludes that the SEC would require that the larger investment advisors file reports electronically that they currently file in paper form. This information would then be sent to the SEC and the appropriate states. The investment advisors expect to incur only marginal costs and to experience some savings as a result of electronic filing.

The bill would also give the SEC the authority to require investment companies to file information, documents, and reports more frequently, to include additional information in their semi-annual reports, and to maintain other records that are similar to those that the SEC currently requires of investment advisers, brokers, and dealers. The SEC does not anticipate changing current filing and recordkeeping requirements as a result of these provisions. Therefore, CBO estimates that investment companies' costs would not be affected.

10. Previous CBO estimate: On June 6, 1996, CBO prepared cost estimates for H.R. 3005, the Securities Amendments of 1996, as ordered reported by the House Committee on Commerce on May 15, 1996. On June 12, 1996, CBO provided a revised intergovernmental mandates cost estimate for H.R. 3005 to reflect a technical and conforming change to the base text of H.R. 3005 regarding the scope of the preemption of state registration requirements. The impact on the federal budget of the two bills differs primarily because S. 1815 authorizes appropriations for fiscal years 1997 and 1998.

11. Estimate prepared by: Federal Cost Estimate: Rachel Forward and Stephanie Weiner. State and Local Government Impact: Pepper Santalucia. Private-Sector Impact: Jean Wooster.

12. Estimate approved by: Robert A. Sunshine for Paul N. Van de Water, Assistant Director for Budget Analysis.

○