

109TH CONGRESS
1ST SESSION

S. 1037

To require disclosure of financial relationships between brokers and mutual fund companies, and of certain brokerage commissions paid by mutual fund companies.

IN THE SENATE OF THE UNITED STATES

MAY 16, 2005

Mr. AKAKA introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

A BILL

To require disclosure of financial relationships between brokers and mutual fund companies, and of certain brokerage commissions paid by mutual fund companies.

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

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the “Mutual Fund Trans-
5 parency Act of 2005”.

1 **SEC. 2. DISCLOSURE OF FINANCIAL RELATIONSHIPS BE-**
2 **TWEEN BROKERS AND MUTUAL FUND COM-**
3 **PANIES.**

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

7 “(13) CONFIRMATION OF TRANSACTIONS FOR
8 MUTUAL FUNDS.—

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

14 “(i) the amount of any compensation
15 received or to be received by the broker in
16 connection with such transaction from any
17 sources; and

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

20 “(B) REVENUE SHARING.—The term ‘com-
21 pensation’ under subparagraph (A) shall in-
22 clude any direct or indirect payment made by
23 an investment adviser (or any affiliate of an in-
24 vestment adviser) to a broker or dealer for the
25 purpose of promoting the sales of securities of
26 an open-end company.

1 “(C) TIMING OF DISCLOSURE.—The disclo-
2 sure required under subparagraph (A) shall be
3 made to a customer not later than as of the
4 date of the completion of the transaction.

5 “(D) LIMITATION.—The disclosures re-
6 quired under subparagraph (A) may not be
7 made exclusively in—

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

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

12 “(E) COMMISSION AUTHORITY.—

13 “(i) IN GENERAL.—The Commission
14 shall promulgate such final rules as are
15 necessary to carry out this paragraph not
16 later than 1 year after the date of enact-
17 ment of the Mutual Fund Transparency
18 Act of 2005.

19 “(ii) FORM OF DISCLOSURE.—Disclo-
20 sures under this paragraph shall be in
21 such form as the Commission, by rule,
22 shall require.

23 “(F) DEFINITION.—In this paragraph, the
24 term ‘open-end company’ has the same meaning

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

3 (b) DISCLOSURE OF BROKERAGE COMMISSIONS.—
4 Section 30 of the Investment Company Act of 1940 (15
5 U.S.C. 80a-29) is amended by adding at the end the fol-
6 lowing:

7 “(k) DISCLOSURE OF BROKERAGE COMMISSIONS.—
8 The Commission, by rule, shall require that brokerage
9 commissions as an aggregate dollar amount and percent-
10 age of assets paid by an open-end company be included
11 in any disclosure of the amount of fees and expenses that
12 may be payable by the holder of the securities of such com-
13 pany for purposes of—

14 “(1) the registration statement of that open-end
15 company; and

16 “(2) any other filing of that open-end company
17 with the Commission, including the calculation of ex-
18 pense ratios.”.

19 **SEC. 3. MUTUAL FUND GOVERNANCE.**

20 (a) INDEPENDENT FUND BOARDS.—Section 10(a) of
21 the Investment Company Act of 1940 (15 U.S.C. 80a-
22 10(a)) is amended—

23 (1) by striking “shall have” and inserting the
24 following: “shall—

25 “(1) have”;

1 (2) by striking “60 per centum” and inserting
2 “25 percent”;

3 (3) by striking the period at the end and insert-
4 ing a semicolon; and

5 (4) by adding at the end the following:

6 “(2) have as chairman of its board of directors
7 an interested person of such registered company; or

8 “(3) have as a member of its board of directors
9 any person that is an interested person of such reg-
10 istered investment company—

11 “(A) who has served without being ap-
12 proved or elected by the shareholders of such
13 registered investment company at least once
14 every 5 years; and

15 “(B) unless such director has been found,
16 on an annual basis, by a majority of the direc-
17 tors who are not interested persons, after rea-
18 sonable inquiry by such directors, not to have
19 any material business or familial relationship
20 with the registered investment company, a sig-
21 nificant service provider to the company, or any
22 entity controlling, controlled by, or under com-
23 mon control with such service provider, that is
24 likely to impair the independence of the direc-
25 tor.”.

1 (b) ACTION BY INDEPENDENT DIRECTORS.—Section
2 10 of the Investment Company Act of 1940 (15 U.S.C.
3 80a–10) is amended by adding at the end the following:

4 “(i) ACTION BY BOARD OF DIRECTORS.—No action
5 taken by the board of directors of a registered investment
6 company may require the vote of a director who is an in-
7 terested person of such registered investment company.

8 “(j) INDEPENDENT COMMITTEE.—

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

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

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

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

23 (c) DEFINITION OF INTERESTED PERSON.—Section
24 2(a)(19) of the Investment Company Act of 1940 (15
25 U.S.C. 80a–2) is amended—

1 (1) in subparagraph (A)—

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

4 (B) by striking clause (vii) and inserting
5 the following:

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

15 “(viii) any natural person who has
16 served as an officer or director, or as an
17 employee within the preceding 10 fiscal
18 years, of any entity that has within the
19 preceding 5 fiscal years acted as a signifi-
20 cant service provider to such registered in-
21 vestment company, or of any entity con-
22 trolling, controlled by, or under the com-
23 mon control with such service provider;

24 “(ix) any natural person who is a
25 member of a class of persons that the

1 Commission, by rule or regulation, deter-
2 mines is unlikely to exercise an appropriate
3 degree of independence as a result of—

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

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

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

14 (2) in subparagraph (B)—

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

17 (B) by striking clause (vii) and inserting
18 the following:

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

24 “(I) a material business relation-
25 ship with such investment adviser or

1 principal underwriter or affiliated per-
 2 son of such investment adviser or
 3 principal underwriter;

4 “(II) a close familial relationship
 5 with any natural person who is an af-
 6 filiated person of such investment ad-
 7 viser or principal underwriter; or

8 “(III) any other reason as deter-
 9 mined by the Commission:”.

10 (d) DEFINITION OF SIGNIFICANT SERVICE PRO-
 11 VIDER.—Section 2(a) of the Investment Company Act of
 12 1940 (15 U.S.C. 80a–2(a)) is amended by adding at the
 13 end the following:

14 “(53) SIGNIFICANT SERVICE PROVIDER.—

15 “(A) IN GENERAL.—Not later than 270
 16 days after the date of enactment of the Mutual
 17 Fund Transparency Act of 2005, the Securities
 18 and Exchange Commission shall issue final
 19 rules defining the term ‘significant service pro-
 20 vider’.

21 “(B) REQUIREMENTS.—The definition de-
 22 veloped under paragraph (1) shall include, at a
 23 minimum, the investment adviser and principal
 24 underwriter of a registered investment company
 25 for purposes of paragraph (19).”.

1 **SEC. 4. FINANCIAL LITERACY AMONG MUTUAL FUND IN-**
2 **VESTORS STUDY.**

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

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

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

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

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

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

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

25 (1) the Committee on Banking, Housing, and
26 Urban Affairs of the Senate; and

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

3 **SEC. 5. STUDY REGARDING MUTUAL FUND ADVERTISING.**

4 (a) IN GENERAL.—The Comptroller General of the
5 United States shall conduct a study on mutual fund adver-
6 tising to identify—

7 (1) existing and proposed regulatory require-
8 ments for open-end investment company advertise-
9 ments;

10 (2) current marketing practices for the sale of
11 open-end investment company shares, including the
12 use of unsustainable past performance data, funds
13 that have merged, and incubator funds;

14 (3) the impact of such advertising on con-
15 sumers; and

16 (4) recommendations to improve investor pro-
17 tections in mutual fund advertising and additional
18 information necessary to ensure that investors can
19 make informed financial decisions when purchasing
20 shares.

21 (b) REPORT.—Not later than 1 year after the date
22 of enactment of this Act, the Comptroller General of the
23 United States shall submit a report on the results of the
24 study conducted under subsection (a) to—

1 (1) the Committee on Banking, Housing, and
2 Urban Affairs of the United States Senate; and

3 (2) the Committee on Financial Services of the
4 House of Representatives.

5 **SEC. 6. POINT-OF-SALE DISCLOSURE.**

6 (a) IN GENERAL.—Section 15(b) of the Securities
7 Exchange Act of 1934 (15 U.S.C. 78o(b)), as amended
8 by section 2, is amended by adding at the end the fol-
9 lowing:

10 “(14) BROKER DISCLOSURES IN MUTUAL FUND
11 TRANSACTIONS.—

12 “(A) IN GENERAL.—Each broker shall dis-
13 close in writing to each person that purchases
14 the shares of an investment company registered
15 under section 8 of the Investment Company Act
16 of 1940 (15 U.S.C. 80a-8)—

17 “(i) the source and amount, in dollars
18 and as a percentage of assets, of any com-
19 pensation received or to be received by the
20 broker in connection with such transaction
21 from any sources;

22 “(ii) the amount, in dollars and as a
23 percentage of assets, of compensation re-
24 ceived in connection with transactions in
25 shares of other investment company shares

1 offered by the broker, if materially dif-
2 ferent from the amount under (i);

3 “(iii) comparative information that
4 shows the average amount received by bro-
5 kers in connection with comparable trans-
6 actions, as determined by the Commission;
7 and

8 “(iv) such other information as the
9 Commission determines appropriate.

10 “(B) REVENUE SHARING.—The term ‘com-
11 pensation’ under subparagraph (A) shall in-
12 clude any direct or indirect payment made by
13 an investment adviser (or any affiliate of an in-
14 vestment adviser) to a broker or dealer for the
15 purpose of promoting the sales of securities of
16 a registered investment company.

17 “(C) TIMING OF DISCLOSURE.—The disclo-
18 sures required under subparagraph (A) shall be
19 made to permit the person purchasing the
20 shares to evaluate such disclosures before decid-
21 ing to engage in the transaction.

22 “(D) LIMITATION.—The disclosures re-
23 quired under subparagraph (A) may not be
24 made exclusively in—

1 “(i) a registration statement or pro-
2 spectus of a registered investment com-
3 pany; or

4 “(ii) any other filing of a registered
5 investment company with the Commission.

6 “(E) COMMISSION AUTHORITY.—The Com-
7 mission shall promulgate such final rules as are
8 necessary to carry out this paragraph not later
9 than 1 year after the date of enactment of the
10 Mutual Fund Transparency Act of 2005.”.

11 (b) NATIONAL SECURITIES ASSOCIATION REQUIRE-
12 MENTS.—Section 15A of the Securities Exchange Act of
13 1934 (15 U.S.C. 78o-3) is amended by adding at the end
14 the following:

15 “(n) NATIONAL SECURITIES ASSOCIATION REQUIRE-
16 MENTS.—Each national securities association registered
17 pursuant to this section shall issue such rules as necessary
18 not later than 1 year after the date of enactment of the
19 Mutual Fund Transparency Act of 2005 to require that
20 a broker that provides individualized investment advice to
21 a person shall—

22 “(1) have a fiduciary duty to that person;

23 “(2) act solely in the best interests of that per-
24 son; and

1 “(3) fully disclose all potential conflicts of inter-
2 est and other information that is material to the re-
3 lationship to that person prior to the time that the
4 investment advice is first provided to the person and
5 at least annually thereafter.”.

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