

**AMENDMENT IN THE NATURE OF A SUBSTITUTE
TO H.R. 2420
OFFERED BY MR. OXLEY**

Strike all after the enacting clause and insert the following:

1 **SECTION 1. SHORT TITLE.**

2 This Act may be cited as the “Mutual Funds Integ-
3 rity and Fee Transparency Act of 2003”.

4 **SEC. 2. IMPROVED TRANSPARENCY OF MUTUAL FUND**
5 **COSTS.**

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

17 (1) The estimated amount, in dollars for each
18 \$1,000 of investment in the company, of the oper-



1 ating expenses of the company that are borne by
2 shareholders.

3 (2) The structure of, or method used to deter-
4 mine, the compensation of individuals employed by
5 the investment adviser of the company to manage
6 the portfolio of the company.

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

12 (4) Information concerning the company's poli-
13 cies and practices with respect to the payment of
14 commissions for effecting securities transactions to a
15 member of an exchange, broker, or dealer who—

16 (A) furnishes advice, either directly or
17 through publications or writings, as to the value
18 of securities, the advisability of investing in,
19 purchasing, or selling securities, and the avail-
20 ability of securities or purchasers or sellers of
21 securities;

22 (B) furnishes analyses and reports con-
23 cerning issuers, industries, securities, economic
24 factors and trends, portfolio strategy, and the
25 performance of accounts; or



1 (C) facilitates the sale and distribution of
2 the company's shares.

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

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

11 (b) APPROPRIATE DISCLOSURE DOCUMENT.—

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

18 (2) EXCEPTION FOR MANAGER'S COMPENSA-
19 TION AND COMMISSIONS.—Notwithstanding para-
20 graph (1), the disclosures required by paragraph (2)
21 and (4) of subsection (a) may be considered to be
22 made in an appropriate disclosure document if the
23 disclosure is made exclusively in a prospectus or
24 statement of additional information, or both such
25 documents.



1 (c) CONCEPT RELEASE REQUIRED.—

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

10 (2) REPORT AND RECOMMENDATIONS RE-
11 QUIRED.—The Commission shall submit a report on
12 the findings from the concept release required by
13 paragraph (1), as well as legislative and regulatory
14 recommendations, if any, to the Committee on Fi-
15 nancial Services of the House of Representatives and
16 the Committee on Banking, Housing, and Urban Af-
17 fairs of the Senate, no later than 270 days after the
18 date of enactment of this Act.

19 (d) ADDITIONAL REQUIREMENT FOR FEE STATE-
20 MENT.—

21 (1) IN GENERAL.—Not later than 270 days
22 after the date of enactment of this Act, the Commis-
23 sion shall prescribe a rule to require, with respect to
24 an open-end management investment company, in
25 the quarterly statement or other periodic report, or



1 other appropriate disclosure document, a statement
2 informing shareholders that such shareholders have
3 paid fees on their investments, that such fees have
4 been deducted from the amounts shown on the state-
5 ments, and where such shareholders may find addi-
6 tional information regarding the amount of these
7 fees.

8 (2) APPROPRIATE DISCLOSURE DOCUMENT.—
9 The statement required by paragraph (1) shall not
10 be considered to be made in an appropriate disclo-
11 sure document unless such statement is made in
12 each periodic statement to a shareholder that—

13 (A) discloses the value of the holdings of
14 the shareholder in the securities of the com-
15 pany; and

16 (B) prominently displays, in a location in
17 close proximity to the statement of the share-
18 holder's account value, such required statement.

19 (3) CONSIDERATIONS.—In prescribing a rule
20 under this subsection, the Commission shall give
21 consideration to methods for reducing for small in-
22 vestment companies the burdens of making the dis-
23 closures required by such rule, consistent with the
24 public interest and the protection of investors.



1 **SEC. 3. OBLIGATIONS REGARDING CERTAIN DISTRIBUTION**
2 **AND SOFT DOLLAR ARRANGEMENTS.**

3 (a) REPORTING REQUIREMENT.—Section 15 of the
4 Investment Company of 1940 (15 U.S.C. 80a–15) is
5 amended by adding at the end the following new sub-
6 section:

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

9 “(1) REPORTING REQUIREMENTS.—Each in-
10 vestment adviser to a registered investment company
11 shall, no less frequently than annually, submit to the
12 board of directors of the company a report on—

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

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



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

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

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

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



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

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

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

14 “(A) the term ‘brokerage and research
15 services’ has the same meaning as in section
16 28(e)(3) of the Securities Exchange Act of
17 1934; and

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

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



1 (1) if any research services—

2 (A) are provided by a member of an ex-
3 change, broker, or dealer who effects securities
4 transactions in an account, and

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

8 any person exercising investment discretion with re-
9 spect to such account shall maintain a copy of the
10 written contract between the person preparing such
11 research and the member of an exchange, broker or
12 dealer; and

13 (2) such contract shall describe the nature and
14 value of the services provided.

15 **SEC. 4. MUTUAL FUND GOVERNANCE.**

16 (a) **DIRECTOR AND CHAIRMAN INDEPENDENCE.**—
17 Section 10(a) of the Investment Company Act of 1940 (15
18 U.S.C. 80a-10) is amended—

19 (1) by striking “60 per centum” and inserting
20 “one-third”; and

21 (2) by inserting “, nor shall such registered in-
22 vestment company have as chairman of such board
23 an interested person of such registered investment
24 company” before the period.



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

4 (1) in subparagraph (A)—

5 (A) by striking clause (vi) and redesignig-
6 nating clause (vii) as clause (vi); and

7 (B) by amending clause (v) to read as fol-
8 lows:

9 “(v) any natural person who is a
10 member of a class of persons who the
11 Commission, by rule or regulation, deter-
12 mines are unlikely to exercise an appro-
13 priate degree of independence as a result
14 of—

15 “(I) a material business or pro-
16 fessional relationship with the com-
17 pany or any affiliated person of the
18 company, or

19 “(II) a close familial relationship
20 with any natural person who is an af-
21 filiated person of the company,”; and

22 (2) in subparagraph (B)—

23 (A) by striking clause (vi) and redesignig-
24 nating clause (vii) as clause (vi); and



1 (B) by amending clause (v) to read as fol-
2 lows:

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

9 “(I) a material business or pro-
10 fessional relationship with such invest-
11 ment adviser or principal underwriter
12 (or affiliated person thereof), or

13 “(II) a close familial relationship
14 with a natural person who is such in-
15 vestment adviser or principal under-
16 writer (or affiliated person thereof).”.

17 **SEC. 5. AUDIT COMMITTEE REQUIREMENTS FOR INVEST-**
18 **MENT COMPANIES.**

19 (a) AMENDMENTS.—Section 32 of the Investment
20 Company Act of 1940 (15 U.S.C. 80a–31) is amended—

21 (1) in subsection (a)—

22 (A) by striking paragraphs (1) and (2) and
23 inserting the following:

24 “(1) such accountant shall have been selected
25 at a meeting held within 30 days before or after the



1 beginning of the fiscal year or before the annual
2 meeting of stockholders in that year by the vote,
3 cast in person, of a majority of the members of the
4 audit committee of such registered investment com-
5 pany;

6 “(2) such selection shall have been submitted
7 for ratification or rejection at the next succeeding
8 annual meeting of stockholders if such meeting be
9 held, except that any vacancy occurring between an-
10 nual meetings, due to the death or resignation of the
11 accountant, may be filled by the vote of a majority
12 of the members of the audit committee of such reg-
13 istered investment company, cast in person at a
14 meeting called for the purpose of voting on such ac-
15 tion;” and

16 (B) by adding at the end the following new
17 sentence: “The Commission, by rule, regulation,
18 or order, may exempt a registered investment
19 company subject to this subsection from the re-
20 quirement in paragraph (1) that the votes by
21 the members of the audit committee be cast at
22 a meeting in person.”; and

23 (2) by adding at the end the following new sub-
24 section:

25 “(d) AUDIT COMMITTEE REQUIREMENTS.—



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

10 “(2) RESPONSIBILITY RELATING TO INDE-
11 PENDENT PUBLIC ACCOUNTANTS.—The audit com-
12 mittee of the registered company, in its capacity as
13 a committee of the board of directors, shall be di-
14 rectly responsible for the appointment, compensa-
15 tion, and oversight of the work of any independent
16 public accountant employed by such registered com-
17 pany (including resolution of disagreements between
18 management and the auditor regarding financial re-
19 porting) for the purpose of preparing or issuing the
20 audit report or related work, and each such inde-
21 pendent public accountant shall report directly to
22 the audit committee.

23 “(3) INDEPENDENCE.—

24 “(A) IN GENERAL.—Each member of the
25 audit committee of the registered company shall



1 be a member of the board of directors of the
2 company, and shall otherwise be independent.

3 “(B) CRITERIA.—In order to be considered
4 to be independent for purposes of this para-
5 graph, a member of an audit committee of a
6 registered company may not, other than in his
7 or her capacity as a member of the audit com-
8 mittee, the board of directors, or any other
9 board committee—

10 “(i) accept any consulting, advisory,
11 or other compensatory fee from the reg-
12 istered company or the investment adviser
13 or principal underwriter of the registered
14 company; or

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

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

20 “(A) the receipt, retention, and treatment
21 of complaints received by the registered com-
22 pany regarding accounting, internal accounting
23 controls, or auditing matters; and

24 “(B) the confidential, anonymous submis-
25 sion by employees of the registered company



1 and its investment adviser or principal under-
2 writer of concerns regarding questionable ac-
3 counting or auditing matters.

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

9 “(6) FUNDING.—The registered company shall
10 provide appropriate funding, as determined by the
11 audit committee, in its capacity as a committee of
12 the board of directors, for payment of
13 compensation—

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

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

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

22 “(A) a committee (or equivalent body) es-
23 tablished by and amongst the board of directors
24 of a registered investment company for the pur-
25 pose of overseeing the accounting and financial



1 reporting processes of the company and audits
2 of the financial statements of the company; and

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

6 (b) CONFORMING AMENDMENT.—Section 10A(m) of
7 the Securities Exchange Act of 1934 is amended by add-
8 ing at the end the following new paragraph:

9 “(7) EXEMPTION FOR INVESTMENT COMPA-
10 NIES.—Effective one year after the date of enact-
11 ment of the Mutual Funds Integrity and Fee Trans-
12 parency Act of 2003, for purposes of this subsection,
13 the term ‘issuer’ shall not include any investment
14 company that is registered under section 8 of the In-
15 vestment Company Act of 1940.”.

16 (c) IMPLEMENTATION.—Not later than 180 days
17 after the date of enactment of this Act, the Securities and
18 Exchange Commission shall issue final regulations to
19 carry out section 32(d) of the Investment Company Act
20 of 1940, as added by subsection (a) of this section.

21 **SEC. 6. TRADING RESTRICTIONS.**

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

25 “(e) TRADING RESTRICTIONS.—



1 “(1) PROHIBITION AND EXCEPTIONS.—No reg-
2 istered investment company shall suspend the right
3 of redemption, or postpone the date of payment or
4 satisfaction upon redemption of any redeemable se-
5 curity in accordance with its terms for more than
6 seven days after the tender of such security to the
7 company or its agents designated for that purpose
8 for redemption, except—

9 “(A) for any period during which the prin-
10 cipal market for the securities in which the
11 company invests is closed or trading restricted,
12 other than customary week-end and holiday
13 closings;

14 “(B) for any period during which an emer-
15 gency exists as a result of which (i) disposal by
16 the company of securities owned by it is not
17 reasonably practicable, or (ii) it is not reason-
18 ably practicable for such company fairly to de-
19 termine the value of its net assets; or

20 “(C) for such other periods as the Com-
21 mission may by order permit for the protection
22 of security holders of the company.

23 “(2) COMMISSION RULES.—The Commission
24 shall by rules and regulations—



1 “(A) determine the conditions under which
2 trading shall be deemed to be restricted;

3 “(B) determine the conditions under which
4 an emergency shall be deemed to exist; and

5 “(C) provide for the determination by each
6 company, subject to such limitations as the
7 Commission shall determine are necessary and
8 appropriate for the protection of investors, of
9 the principal market for the securities in which
10 the company invests.”.

11 **SEC. 7. DEFINITION OF NO-LOAD MUTUAL FUND.**

12 Within 270 days after the date of enactment of this
13 Act, the Securities and Exchange Commission shall, by
14 rule adopted by the Commission or a self-regulatory orga-
15 nization (or both)—

16 (1) clarify the definition of “no-load” as such
17 term is used by investment companies that impose
18 any fee under a plan adopted pursuant to rule 12b-
19 1 of the Commission’s rules (17 CFR 270.12b-1);
20 and

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



1 **SEC. 8. INFORMING DIRECTORS OF SIGNIFICANT DEFICIENCIES.**
2

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

6 “(f) INFORMING DIRECTORS OF SIGNIFICANT DEFICIENCIES.—If the report of an inspection by the Commis-
7 sion of a registered investment company identifies signifi-
8 cant deficiencies in the operations of such company, or of
9 its investment adviser or principal underwriter, the com-
10 pany shall provide such report to the directors of such
11 company.”.

13 **SEC. 9. EXEMPTION FROM IN PERSON MEETING REQUIREMENTS.**
14

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

23 **SEC. 10. COMMISSION STUDY AND REPORT REGULATING**
24 **SOFT DOLLAR ARRANGEMENTS.**

25 (a) STUDY REQUIRED.—



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

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

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

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

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

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



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

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

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

18 (b) REPORT REQUIRED.—The Commission shall sub-
19 mit a report on the study required by subsection (a) to
20 the Committee on Financial Services of the House of Rep-
21 resentatives and the Committee on Banking, Housing and
22 Urban Affairs of the Senate, no later than one year after
23 the date of enactment of this Act.



1 **SEC. 11. STUDY OF ARBITRATION CLAIMS.**

2 (a) **STUDY REQUIRED.**—The Securities and Ex-
3 change Commission shall conduct a study of the increased
4 rate of arbitration claims and decisions involving mutual
5 funds since 1995 for the purposes of identifying trends
6 in arbitration claim rates and, if applicable, the causes of
7 such increased rates and the means to avert such causes.

8 (b) **REPORT.**—The Securities and Exchange Commis-
9 sion shall submit a report on the study required by sub-
10 section (a) to the Committee on Financial Services of the
11 House of Representatives and the Committee on Banking,
12 Housing, and Urban Affairs of the Senate not later than
13 one year after the date of enactment of this Act.

