

**MEMO# 2319**

November 14, 1990

## **SUMMARY OF LEGISLATIVE ACTIVITY - CONCLUSION OF 101ST CONGRESS**

November 14, 1990 TO: BOARD OF GOVERNORS NO. 80-90 FEDERAL LEGISLATION  
MEMBERS NO. 8-90 FEDERAL LEGISLATION COMMITTEE NO. 7-90 RE: SUMMARY OF  
LEGISLATIVE ACTIVITY - CONCLUSION OF 101ST CONGRESS

Working nearer to an election date than at any other time since World War II, the 101st Congress adjourned on October 28, as the President and the Congress agreed to a Budget Resolution. Despite the dominance of the Budget debate, the 101st Congress was active on many other issues, including significant securities legislation. This memo summarizes the disposition of matters of concern to the Institute in the 101st Congress.

**I. TAX LEGISLATION**

**A. "OMNIBUS BUDGET RECONCILIATION ACT OF 1990"**

**1. SECURITIES TRANSFER EXCISE TAX** The development of "revenue options" to reduce the deficit was a source of constant concern to all involved in the Budget process. Under serious consideration as one such "revenue option" was the Securities Transfer Excise Tax, otherwise known as the STET. The Institute opposed efforts to include the STET in the Budget Resolution. In numerous meetings with Congressional and Administration officials, the Institute noted the "double-layer" tax on both mutual funds and their shareholders and documented the debilitating effect such a tax would have on money market fund yields. The Institute's opposition to the STET was broadly shared by many national organizations including the American Bankers Association, American Council of Life Insurance, American Stock Exchange, Association of Private Pension and Welfare Plans, Government Finance Officers Association, National Association of State Retirement Administrators, National Association of State Treasurers, National League of Cities, New York Stock Exchange - 2 - and the Securities Industry Association. Although considered until the very end, the STET was not included in the Budget Resolution.

**2. PRO-SAVINGS INCENTIVES** Early in the year, both the Administration and many in Congress expressed support for the creation of expanded "savings" programs. The Institute testified before the Congress in favor of such incentives. Provisions in the Administration's initiative - "The Savings and Economic Growth Act" - would have established Family Savings Accounts (FSAs) and also permitted IRA owners to withdraw up to \$10,000 from an IRA for a first-time home purchase on a penalty-free basis. At the same time, Senate Finance Committee Chairman Lloyd Bentsen offered a liberalized version of the existing IRA and Senators Packwood and Roth offered what came to be known as the "back-end" IRA. Although these legislative efforts were supported by the Administration and key Members of Congress, they were not included in the Budget Resolution because of the revenue cost associated with them.

**3. REPEAL OF THE 30% TEST** The Institute advocated the repeal of the 30% test. S. 3129, "to amend the Internal Revenue Code of 1986 to repeal the 30-percent gross income limitation on regulated investment companies", was introduced by Senators Alan Dixon (D-IL), Paul Simon (D-IL) and Thomas Daschle (D-SD) and considered at various stages during

the Senate Finance Committee deliberations on the tax bill. On the House side, Ways and Means Committee members Rep. Ronnie Flippo (D-AL) and Rep. Raymond McGrath (R-NY) intended to offer an amendment to repeal the short-short test. This same amendment passed the House in the 100th Congress; as such, no opposition to the effort was anticipated. However, Committee parliamentary procedure prevented all such amendments from being considered.

4. PASSIVE FOREIGN INVESTMENT COMPANIES The Institute has been working with the Treasury Department on regulations which would permit mutual funds to invest in certain passive foreign investment companies without incurring a double tax. To date, the Treasury has been undecided as to whether or not it has sufficient authority to promulgate such regulations. Consequently, the Institute sought Congressional affirmation of Treasury's authority to issue such regulatory relief. Even though there appeared to be general agreement on the merits of the Institute's effort, parliamentary procedure did not permit - 3 - the consideration of "extraneous" amendments and therefore prevented the legislative resolution of this matter. In the absence of legislation, Ways and Means Committee Chairman Rostenkowski commented in the Congressional Record that the inaction by the Ways and Means Committee on the PFIC provision "does not alter any authority that the IRS possess[sic] under present law to prescribe regulations in connection with this issue." With such guidance from the Congress, the Institute will continue to pursue this matter at Treasury and, if necessary, on the Hill.

B. TAX SIMPLIFICATION 1. SHAREHOLDER BASIS REPORTING The House Ways and Means Committee staff has published a document that will serve as the basis for Committee consideration of tax simplification legislation. Included in this document is a proposal which would require mutual funds to calculate a shareholder's basis in his or her fund shares and provide this information to the Internal Revenue Service upon the shareholder's request. The Institute expressed its concern over this proposal in a letter to the Ways and Means Committee and expressed its willingness to work with the Committee at the appropriate time. Tax Simplification is a long range project of the Committee and will be the subject of extensive hearings in the 102nd Congress. The Institute expects to testify and be active in this area.

C. INTERNATIONAL COMPETITIVENESS The Institute testified before the House Ways and Means Committee and outlined its support for tax code changes which would allow the mutual fund industry to compete more effectively abroad. The Institute proposed three amendments which would remove the most serious competitive barriers. These amendments would: 1) allow a U.S. mutual fund to flow through interest income free of U.S. withholding tax; 2) allow a U.S. mutual fund to flow through short-term capital gain free of U.S. withholding tax to its foreign investors; 3) permit the creation of an IRIC - International Regulated Investment Company - a mutual fund product designed to be sold only to foreign investors and to compete with foreign mutual funds. Although the Congress is increasingly concerned about the international competitiveness issue, it did not take any legislative action this year. - 4 -

D. PENSION SIMPLIFICATION Senator David Pryor (D-ARK) and Congressman Rod Chandler (R-WA) introduced legislation (S. 2091, H.R. 5362) aimed at simplifying code provisions regarding qualified retirement plans and IRAs. The Institute submitted testimony endorsing the bill's goals and provided comments on the proposed revision of Code section 402, concerning the transfers of pre-retirement distributions and SEP simplification. Although there was generally strong support for this legislation, it did not move because of revenue and time considerations. It is expected to be reconsidered.

E. THE HEALTH CARE AND LONG-TERM SECURITY ACT OF 1990 (S. 2199) Senator Bob Packwood (R-OR) introduced legislation which would permit employers to prefund retiree health benefit accounts within defined benefit plans under certain circumstances. Of particular interest to the industry is the provision that would permit amounts in the reserve account to be portable upon the employee's separation from service or after termination of the plan, either to a subsequent employer's health benefit account or to an IRA. The

Institute has expressed its interest in certain provisions of this legislation and plans to be active with respect to this legislation in the next Congress.

## II. SECURITIES LEGISLATION

### A. MARKET REFORM

The Market Reform Act (P.L. 101-432) was signed into law October 16, 1990. The legislation gives the SEC enhanced authority to monitor stock trades, halt trading in emergencies, and, in a limited way, restrict program trading. The Institute, testifying in support of the legislation before House and Senate Committees, outlined the Institute's Market Reform Task Force recommendations. Of particular interest to the Institute were the risk assessment provisions, which among other things, authorize the SEC to adopt recordkeeping and reporting requirements for registered broker-dealers. The Institute supported an exemption from this provision for any registered broker-dealer primarily engaged in mutual fund underwriting because the failure of such a broker-dealer would not have a material adverse effect on the securities markets as a whole. The House Committee Report - 5 - recognizes that "[s]ome financial and securities activities, such as ... mutual fund distribution involve lower degrees of risk and a lower probability that financial problems will adversely affect the broker-dealers." The final version of the legislation authorizes the SEC to grant exemptions based on consideration of several factors, including "the nature and extent of the regulated person's securities activities."

### B. SECURITIES LAW ENFORCEMENT

The Securities Law Enforcement Remedies and Penny Stock Act (P.L. 101-429) was signed into law on October 15, 1990. The legislation revises SEC regulation of the penny stock market to curtail fraud and abuse and strengthens the Commission's authority to enforce securities laws, including authority to impose cease-and-desist orders and fines for civil violations of federal securities laws. The Senate Banking Committee report indicates that the Committee does not normally expect the SEC to seek penalties against registered investment companies. Penalties would generally be assessed against responsible individuals.

### C. SECURITIES ACT AMENDMENTS

The "Securities Act Amendments" incorporated three bills that were of interest to the Institute: 1) the "International Securities Enforcement Cooperation Act", a bill to enhance coordination between U.S. and foreign securities regulatory authorities and to expand the authority of the SEC and self-regulatory organizations to bar individuals from trading based on securities convictions in a foreign country; 2) the SEC reauthorization legislation; the Institute supported an increase in the amount of the SEC authorization. 3) the "Shareholder Communication Act of 1989", a bill to improve the flow of proxy and other information to mutual fund shareholders. It requires banks and broker-dealers that hold mutual fund shares on behalf of customers to forward proxy materials to those customers. The Institute supported this bill. This legislation has not yet been signed by the President.

### - 6 - D. SEC/CFTC JURISDICTION

Bills were introduced in both the House and Senate (H.R. 5006 and S. 2814) that would give the SEC jurisdiction over stock index futures and oversight authority over margins for the products. The Senate Banking and Agriculture Committees held hearings on the Administration's proposals, but no action was taken. The Institute submitted a letter supporting the proposal.

### E. SEC APPROPRIATIONS

Congress appropriated \$190 million to the SEC for FY 1991. The legislation makes permanent the Section 6(b) fee increase (from 1/50th of 1% to 1/40th of 1%) and also stipulates that the funds generated from increasing the fees will be deposited as an offsetting collection to the appropriation to recover the cost of services of the securities registration process. The Institute supports the efforts to permit the SEC to become self-funding, subject to Congressional oversight.

### F. INVESTMENT COMPANY ACT OF 1940

The Institute has submitted its recommendations to the SEC on its proposal to revise the Investment Company Act of 1940. This issue will be on the SEC's agenda in the 102nd Congress and legislative consideration is anticipated.

### G. WYDEN ACCOUNTING AMENDMENT

The House-passed version of the "Omnibus Crime Bill" (H.R. 5269) contained an amendment requiring management reports on internal financial control structures and auditor reporting on those structures, standards for audit design and reporting of illegal

acts to the SEC. This amendment would have applied to all corporations currently required to register with the SEC, including mutual funds. The Wyden amendment was not included in the final legislation.

### III. BANKING LEGISLATION

#### A. FINANCIAL SERVICES INDUSTRY RESTRUCTURING

The Senate Banking Committee completed a series of 13 hearings on the modernization of the financial services industry. The Institute testified before the Committee, emphasizing that any restructuring of the industry must include a competitive two-way street for banking and securities companies with accompanying - 7 - firewalls and functional regulation to insure the safety and soundness of the banking system. The Institute likewise testified before the House Subcommittee on Telecommunications and Finance. No legislative action was taken during the 101st Congress. Action on deposit insurance reform is expected to kick-off the financial services debate in the 102nd Congress. The Treasury Department's long awaited recommendations for deposit insurance reform may be issued before the end of this year and may also incorporate plans for financial services restructuring. Additionally, the international competitive ability of U.S. financial institutions will continue to serve as a cornerstone of legislative proposals to restructure the financial services industry. The Institute testified before the House Banking Committee's Task Force on International Competitiveness of U.S. Financial Institutions, chaired by Congressman John LaFalce (D-NY). The report of the Task Force is being printed.

#### B. OCC PROPOSED REGULATIONS

On February 1, 1990, the Office of the Comptroller of the Currency proposed changes to its regulations governing common trust funds managed by national banks. The changes would eliminate current restrictions on advertising and on management fees. The Institute opposes these changes, has submitted comments to the Comptroller, and has outlined its objections at the House Subcommittee on Telecommunications and Finance's October 4th hearing. No action has been taken by the Comptroller, but promulgation of regulations can occur at anytime. The Institute remains very active in its opposition to the Comptroller's proposal.

#### C. FAIR TRADE IN FINANCIAL SERVICES

The Institute testified before the Senate Banking Committee in support of S. 2028, the "Fair Trade in Financial Services Act of 1990". The bill would authorize the SEC to deny registration as an investment adviser to a person from a foreign country that, according to a finding by the Treasury Department, fails to offer effective market access to U.S. advisers. Although the legislation passed the Senate and House as part of larger bills, the measure died because of political objections unrelated to S. 2028.

#### - 8 - D. INVESTMENT ADVISERS

H.R. 4441, the "Investment Advisers Disclosure and Enforcement Act of 1990" was introduced by Congressman Rick Boucher (D-VA) and co-sponsored by Energy and Commerce Committee Chairman John Dingell and Securities Subcommittee Chairman Ed Markey. The bill would require all financial planners and investment advisers to register as investment advisers under the 1940 Investment Advisers Act; require a statement of education and experience of the investment adviser; create a private right of action; and establish a list of civil penalties for the SEC to pursue under the Act. The Institute submitted testimony on the bill, but other than a hearing, no legislative action was taken on the proposal. This issue is expected to be considered next year.

#### E. TRUTH-IN-SAVINGS

Both the House and Senate passed versions of Truth-in-Savings legislation which would have required depository institutions to make uniform disclosures about costs associated with demand and interest-bearing accounts. The Institute supported this legislation. However, of concern to the Institute was a provision in the Senate bill which would have required the SEC to consult with the Federal Reserve Board on an annual basis and, if necessary, change regulations which govern mutual fund advertising to reflect bank regulation. Both the SEC and Energy and Commerce Committee Chairman John Dingell opposed the provision that required the SEC to change its rules to reflect bank advertising standards. The bill was not considered for final passage for reasons unrelated to this provision. Additional information about these issues is available from the Institute's Legislative Affairs Department (202)

955-3544. This report is also available on FUNDS, the Institute's Fund User Network and Delivery System, under Legislative Affairs, Upcoming Congressional Hearings. Julie Domenick Vice-President - Legislative Affairs

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