The Asset Management Industry
SERVING INDIVIDUAL INVESTORS

INVESTMENT COMPANY INSTITUTE

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PROPOSED MUTUAL FUND LEGISLATION

 [18867] May 19, 2005 TO: ACCOUNTING/TREASURERS MEMBERS No. 8-05 BOARD OF GOVERNORS No. 23-05 CLOSED-END INVESTMENT COMPANY MEMBERS No. 31-05 FEDERAL LEGISLATION MEMBERS No. 3-05 INVESTMENT COMPANY DIRECTORS No. 13-05 PRIMARY CONTACTS - MEMBER COMPLEX No. 21-05 PUBLIC COMMUNICATIONS COMMITTEE No. 6-05 SEC RULES MEMBERS No. 66-05 SMALL FUNDS MEMBERS No. 46-05 UNIT INVESTMENT TRUST MEMBERS No. 11-05 RE: PROPOSED MUTUAL FUND LEGISLATION Senator Daniel K. Akaka (D-HI), the Ranking Member of the Subcommittee on Financial Management, the Budget, and International Security of the Senate Committee on Governmental Affairs, recently introduced S. 1037, the "Mutual Fund Transparency Act of 2005" (the "Act"). The bill, which is attached and summarized below, is a modified version of the mutual fund bill (S. 1822) that Senator Akaka introduced in 2003.1 Provisions that were not in the earlier bill are highlighted.2 Disclosure of Financial Relationships Between Brokers and Mutual Fund Companies Section 2(a) of the bill would direct the SEC, within one year of enactment of the Act, to promulgate rules requiring brokers to disclose in writing to customers who purchase mutual fund shares the amount of compensation received or to be received by the broker in connection with the transaction. In a change from the earlier bill, this provision expressly would require such disclosure to include the amount of revenue sharing payments. The disclosure would 1 For a summary of S. 1822, the "Mutual Fund Transparency Act of 2003," see Memorandum to Board of Governors No. 60-03, Closed-End Investment Company Members No. 89-03, Federal Legislation Members No. 22-03, Investment Company Directors No. 15-03, Primary Contacts – Member Complex No. 96-03, Public Information Committee No. 38-03, SEC Rules Members No. 153-03, Small Funds Members No. 64-03, and Unit Investment Trust Members No. 41- 03, dated November 10, 2003 [16751]. 2 Two provisions of the earlier bill were dropped. The first would have required a study of whether to create a Mutual Fund Oversight Board. The second would have required disclosure concerning portfolio managers' compensation and their ownership of fund shares. 2 have to be made no later than the date of the completion of the transaction. The bill specifies that the disclosure may not be made exclusively in a fund's registration or any fund filing with the SEC. Section 2(b) of the bill would direct the SEC to adopt rules requiring disclosure of fund brokerage commissions, both as an aggregate dollar amount and as a percentage of assets, " in any disclosure of the amount of fees and expenses that may be payable" by fund shareholders for purposes of the fund's registration statement and any other filing of that fund with the SEC, "including the calculation of expense ratios." Mutual Fund Governance Section 3(a) of the bill would amend Section 10(a) of the Investment Company Act of 1940 to require 75% of a fund's board to be independent and to require that the

chairman of the board be independent. In addition, no interested person of the fund could serve as a fund director unless (1) he or she was approved or elected by fund shareholders at least once every 5 years and (2) a majority of the independent directors make an annual finding that the director does not have any material business or familial relationship with the fund, a “significant service provider” to the fund (to be defined by the SEC within 270 days of enactment of the Act), or a person who controls, is controlled by, or is under common control with such service provider, that is likely to impair the director’s independence. Section 3(b) of the bill provides that no action taken by a fund board may require the vote of an interested director. In addition, a fund’s independent directors would be required to form a committee comprised solely of independent directors with responsibility for selecting nominees for election to the board and adopting qualification standards for the nomination of directors. The qualification standards would have to be disclosed in the fund’s registration statement. Also, the bill would expand the definition of “interested person” in Section 2(a)(19) of the Investment Company Act. Financial Literacy Among Mutual Fund Investors Study Section 4 of the bill would require the SEC to conduct a study of the financial literacy of mutual fund investors and to report on the study to the Senate Banking Committee and the House Financial Services Committee within one year after enactment of the Act. Study Regarding Mutual Fund Advertising Section 5 of the bill would require the Comptroller General of the United States to conduct a study on mutual fund advertising and to report on the study to the Senate Banking Committee and the House Financial Services Committee within one year after enactment of the Act. Point-of-Sale Disclosure Section 6(a) of the bill is new. It would direct the SEC, within one year of enactment of the Act, to promulgate rules requiring brokers to disclose in writing to customers who purchase mutual fund shares the source and amount, in dollars and as a percentage of assets, of 3 compensation (including revenue sharing payments) received or to be received by the broker in connection with the transaction. Also, the bill would require brokers to provide customers with information on the differential payments and average fees for comparable transactions. The disclosures would have to be made to permit the person purchasing the shares to evaluate such disclosures before deciding to engage in the transaction. The bill specifies that the disclosures may not be made exclusively in a fund’s registration or any fund filing with the SEC. Section 6(b) of the bill also is new. It would direct each national securities association to adopt rules requiring that a broker that provides individualized investment advice to a person will (1) have a fiduciary duty to that person; (2) act solely in the best interests of that person; and (3) fully disclose all potential conflicts of interests and other material information prior to the time that the investment advice is first provided to the person and at least annually thereafter. Jane G. Heinrichs Assistant Counsel Attachment (in .pdf format) Note: Not all recipients receive the attachment. To obtain a copy of the attachment, please visit our members website (http://members.ici.org) and search for memo 18867, or call the ICI Library at (202) 326-8304 and request the attachment for memo 18867.
