

MEMO# 17641

June 8, 2004

MUTUAL FUND LEGISLATION INTRODUCED BY SENATOR LIEBERMAN

[17641] June 8, 2004 TO: BOARD OF GOVERNORS No. 41-04 CLOSED-END INVESTMENT COMPANY MEMBERS No. 39-04 FEDERAL LEGISLATION MEMBERS No. 13-04 PRIMARY CONTACTS - MEMBER COMPLEX No. 56-04 PUBLIC COMMUNICATIONS COMMITTEE No. 20-04 SEC RULES MEMBERS No. 84-04 SMALL FUNDS MEMBERS No. 63-04 UNIT INVESTMENT TRUST MEMBERS No. 23-04 RE: MUTUAL FUND LEGISLATION INTRODUCED BY SENATOR LIEBERMAN On June 3, Senator Joseph Lieberman (D-CT) introduced S. 2497, the "Small Investor Protection Act of 2004" ("Act"). The bill, which has been referred to the Senate Committee on Banking, Housing and Urban Affairs, is summarized below.* Division of the Investor (Section 3) The bill would require the Securities and Exchange Commission to establish a Division of the Investor. The Division would serve as an advocate for individual investors by, among other things, identifying areas of concern to individual investors that may warrant SEC action and serving as a liaison between investor advocacy organizations and the SEC. The Division also would perform the functions currently handled by the SEC's Office of Investor Education and Assistance (e.g., developing and disseminating educational materials, analyzing investor complaints) and other functions to promote the interests of individual investors. The bill would require that the Division summarize its views on each new SEC rule proposal and that each summary be published as part of the SEC's request for public comment on the relevant proposal. Office of Risk Assessment (Section 4) The bill would require the SEC to establish an Office of Risk Assessment. The Office would be responsible for assessing industry practices, identifying risks associated with those * A copy of S. 2497 is available on the website of the Government Printing Office at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=108_cong_bills&docid=f:s2497is.txt.pdf. 2 practices that could most likely harm investors and the public, and developing strategies to address and mitigate such risks. The Office also would be required to prepare annual reports to the SEC assessing areas that potentially pose the most significant risks to investors during the coming 3-year period. In performing its duties, the Office would have to seek and use information from a wide range of internal and external sources, including: (1) securities filings; (2) information gathered in compliance inspections and examinations; (3) consumer complaints; (4) tips from individuals working within publicly traded corporations or the securities industry; (5) academic research; and (6) relevant information from industry and other sources. Consumer Research (Section 5) Under the bill, whenever the SEC considers requiring significant disclosures to investors, the agency would have to consider and give weight to empirical evidence as to: (1) whether the proposed disclosure as a whole (including its wording, format, context and location in which it appears, and timing and manner of its dissemination) is likely to "meaningfully improve understanding by individual investors to assist them in making wise financial decisions;" and (2) whether alternative disclosures would be more effective in improving investor understanding. The

bill states that such empirical evidence may be qualitative or quantitative and “should be of a type that relevant experts would consider competent and reliable evidence of the understanding of average investors.” Fund Summaries (Section 6) The bill would add to Section 12 of the Investment Company Act of 1940 a new provision that would prohibit any mutual fund from offering its shares for sale unless, prior to completion of the sale, the fund provides investors with a “summary of relevant characteristics of the investment.” The summary would have to include information on expenses, risk, and diversification, as well as any other information that the SEC determines will assist investors in making wise financial decisions. Under the bill, the SEC would have to conduct a study to determine: (1) what information is most likely to assist average fund investors in making wise financial decisions; and (2) the best way to present such information. The bill would direct the SEC to issue, consistent with the study’s findings, rules specifying the content and format of the summary. The bill specifies that the summary must not exceed four printed pages in length. Rachel H. Graham Assistant Counsel

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