The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

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PROPOSED MUTUAL FUND LEGISLATION

[16751] November 10, 2003 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 UNIT INVESTMENT TRUST MEMBERS No. 41-03 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.1822, the “Mutual Fund Transparency Act of 2003” (the “Act”).1 A copy of the bill is attached and it is summarized below. 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. The disclosure would 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.” 1 The bill is co-sponsored by Senator Peter G. Fitzgerald (R-IL), Chairman of the Financial Management Subcommittee, and Senator Joseph I. Lieberman (D-CT), the Ranking Member of the full Committee on Governmental Affairs. 2 Mutual Fund Governance Section 3(a) of the bill would amend Section 10(a) of the Investment Company Act 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), 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. The bill would expand the definition of “interested person” in Section 2(a)(19) of the Investment Company Act to include the following: • any person or partner or employee of

any person who has acted as legal counsel for a fund, its investment adviser or principal underwriter since the beginning of the last 5 completed fiscal years (rather than two years, as is currently the case); • any person who, within the preceding 10 fiscal years, has served as an officer, director or employee of the fund's investment adviser or principal underwriter or an entity that controls, is controlled by, or is under common control with the adviser or underwriter;2 • any person who, within the preceding 10 fiscal years, has served as an officer, director or employee of an entity that has served as a "significant service provider" to the fund at any time within the preceding 5 fiscal years, or of any entity that controls, is controlled by, or is under common control with such service provider; • any person who is a member of a class of persons that the SEC, by rule or regulation, determines is unlikely to exercise an appropriate degree of independence as a result of (1) a material business relationship with the fund, an affiliated person of the fund, the fund's investment adviser or principal underwriter, or an affiliated person of the adviser or underwriter, (2) a close familial relationship with any natural person who is an affiliated person of the fund, its investment adviser or principal underwriter, or (3) any other reason determined by the SEC. 2 Current law authorizes the SEC, by order, to determine that a person is an interested person by reason of having had, at any time since the beginning of the last two fiscal years, a material business or professional relationship with (1) the fund, (2) the fund's principal executive officer, (3) any other fund with the same investment adviser or principal underwriter, (4) the principal executive officer of such other fund, (5) the fund's investment adviser or principal underwriter or (6) the principal executive officer of the adviser or underwriter. 3 The SEC would be required to define "significant service provider" within 270 days of enactment of the Act. For purposes of Section 2(a)(19), the definition would have to include, at a minimum, a fund's investment adviser and principal underwriter. Also, the SEC would be required to conduct a study of whether the best interests of mutual fund investors would be served by the creation of a Mutual Fund Oversight Board that (1) has inspection, examination and enforcement authority over mutual fund boards, (2) is funded by assessments against fund assets, (3) the members of which are selected by the SEC, and (4) has rulemaking authority. The SEC would have to submit a report on this study to the Senate Banking Committee and the House Financial Services Committee within one year after enactment of the Act. Portfolio Manager Compensation Section 4 of the bill would require the SEC, within 270 days of enactment of the Act, to prescribe rules requiring funds to disclose the structure of, or method used to determine, portfolio manager compensation, as well as portfolio managers' ownership of fund shares. Financial Literacy Among Mutual Fund Investors Study Section 5 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 6 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. Frances M. Stadler Deputy Senior Counsel 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 16751, or call the ICI Library at (202) 326-8304 and request the attachment for memo 16751. Attachment (in .pdf format)