



Legislative Bulletin.....November 19, 2003

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H.R. 2420—Mutual Funds Integrity and Fee Transparency Act of 2003

**H.R. 2420 — Mutual Funds Integrity and Fee Transparency Act of 2003
(Oxley)
(With a Manager’s Amendment)**

Order of Business: The bill is scheduled for consideration on Wednesday, November 19, 2003, under a motion to suspend the rules and pass the bill. The bill as reported will be amended on the floor with a manager’s amendment.

Summary: H.R. 2420 requires the Securities and Exchange Commission (SEC) within 270 days to establish new operating policies and federal reporting requirements for the mutual fund industry.

The bill as reported requires the SEC to revise and implement regulations requiring mutual fund companies to disclose certain information to investors. The regulations would **require:**

- Disclosure of operating expenses for each \$1,000 of investment in the company that are borne by shareholders;
- Notification of investors in their brokerage account statements that fees have been deducted;
- Disclosure of portfolio turnover rates, structure of the fund manager's compensation, and where shareholders can find additional information;
- New, at least annual, reporting and record keeping for investment advisors on “soft dollar” transactions;
- New fiduciary duty for board of directors “to determine that the direction of such brokerage is in the best interests of the shareholders of the company” and “to determine that such revenue sharing arrangements are in the best interests of the shareholders of the company” [*Note: the phrase “best interests” is not defined in the bill*];
- Mutual fund boards to decrease the maximum allowable percentage of directors on their boards who are “interested persons” from 60 percent to 1/3;
- Responsibilities of audit committees to be revised;
- Directors to be informed of any significant deficiencies in the operation of a mutual fund discovered in a SEC inspection;
- Disclosure of any holdings managers have in the funds they manage;
- Disclosure to investors whether brokers received extra financial incentives to sell a particular fund or class of shares; and

- The SEC within a year to complete 1) a study of “soft dollar arrangements” over the last 3 years and 2) a study of the increased rate of arbitration claims and decisions involving mutual funds since 1995.

The Manager’s Amendment creates a new Title II of the bill “Prevention of Abusive Mutual Fund Practices.” The new provisions:

- Require each fund to have a code of ethics and chief compliance officer;
- Require investment companies to disclose their code of ethics “and any waivers and material violations” of the code of ethics on a readily accessible electronic public information system;
- Require the non-interested persons on the board to certify that procedures are in place for certain day-to-day operations of the fund company “and that the company is in compliance with such procedures.” The SEC has 90 days to prescribe and implement these new provisions;
- Create, within 90 days, a new ban on the joint management of mutual funds and hedge funds, except in “exceptional circumstances” determined by the SEC and then with strict disclosure requirements;
- Make it illegal to engage in short term trading, as that term is defined by the SEC;
- Eliminate, within 90 days “stale prices” and “unfair after-hours trading”; and
- Require an SEC report to Congress within 180 days on market timing and late trading of mutual funds.

Committee Action: H.R. 2420 was introduced on June 11, 2003, and was referred to the House Financial Services Committee. The Committee reported the bill to the full House by voice vote on July 23, 2003.

Cost to Taxpayers: Based on information from the SEC, CBO estimates that implementing this bill would cost about \$1 million in 2004 and a total of about \$2 million over the 2004-2008 period, subject to appropriations. **H.R. 2420 would impose private-sector mandates on mutual fund companies.** Based on information provided by industry and government sources, CBO expects that the direct costs of complying with those mandates would fall below the threshold established by UMRA for private-sector mandates (\$117 million in 2003).

Does the Bill Create New Federal Programs or Rules?: Yes, the bill requires the SEC to create new operating policies and federal reporting requirements for the mutual fund industry. It creates new fiduciary duties (e.g. personal liability) for mutual fund board members, including certifying whether or not their brokerage is operating “is in the best interests of the shareholders of the company.”

Constitutional Authority: The House Financial Services Committee (in Report No. 108-351) finds authority under Article 1, Section 8, Clause 1 (relating to the defense and general welfare of the United States), and Clause 3 (relating to the power to regulate foreign and interstate commerce).

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