Public Law 104-290
104th Congress

An Act

Oct. 11, 1996
[H.R. 3005]

To amend the Federal securities laws in order to promote efficiency and capital formation in the financial markets, and to amend the Investment Company Act of 1940 to promote more efficient management of mutual funds, protect investors, and provide more effective and less burdensome regulation.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

National Securities Markets Improvement Act of 1996.
15 USC 78a note.

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.-This Act may be cited as the "National Securities Markets Improvement Act of 1996".

(b) TABLE OF CONTENTS.-The table of contents of this Act is as follows:

15 USC 80a-3 note.

(3) EMPLOYEE EXCEPTION.—Not later than 1 year after the date of enactment of this Act, the Commission shall prescribe rules pursuant to its authority under section 6 of the Investment Company Act of 1940 to permit the ownership of securities by knowledgeable employees of the issuer of the securities or an affiliated person without loss of the exception of the issuer under paragraph (1) or (7) of section 3(c) of that Act from treatment as an investment company under that Act.

15 USC 80a-3 note.

(4) BENEFICIAL OWNERSHIP.—Not later than 180 days after the date of enactment of this Act, the Commission shall prescribe rules defining the term "beneficial owner" for purposes of section 3(c)(7)(B) of the Investment Company Act of 1940, as amended by this Act.

15 USC 80a-2 note.

(e) EFFECTIVE DATE.—The amendments made by this section shall take effect on the earlier of—

(1) 180 days after the date of enactment of this Act; or

(2) the date on which the rulemaking required under subsection (d)(2) is completed.

SEC. 210. PERFORMANCE FEES EXEMPTIONS.

Section 205 of the Investment Advisers Act of 1940 (15 U.S.C. 80b-5) is amended—

(1) in subsection (b)—

(A) in paragraph (2) by striking "or" at the end;

(B) in paragraph (3), by striking the period at the end and inserting a semicolon; and

(C) by adding at the end the following new paragraphs:

"(4) apply to an investment advisory contract with a company excepted from the definition of an investment company under section 3(c)(7) of title I of this Act; or

"(5) apply to an investment advisory contract with a person who is not a resident of the United States."; and

(2) by adding at the end the following new subsection:

"(e) The Commission, by rule or regulation, upon its own motion, or by order upon application, may conditionally or unconditionally exempt any person or transaction, or any class or classes of persons or transactions, from subsection (a)(1), if and to the extent that the exemption relates to an investment advisory contract with any person that the Commission determines does not need the protections of subsection (a)(1), on the basis of such factors as financial sophistication, net worth, knowledge of and experience in financial matters, amount of assets under management, relationship with a registered investment adviser, and such other factors as the Commission determines are consistent with this section.".

Investment Advisers Supervision Coordination Act.

TITLE III—INVESTMENT ADVISERS SUPERVISION COORDINATION ACT

15 USC 80b-20 note.

SEC. 301. SHORT TITLE.

This title may be cited as the "Investment Advisers Supervision Coordination Act".

SEC. 302. FUNDING FOR ENHANCED ENFORCEMENT PRIORITY.

Appropriation authorization

There are authorized to be appropriated to the Commission, for the enforcement of the Investment Advisers Act of 1940, not more than $20,000,000 in each of fiscal years 1997 and 1998, in addition to any funds authorized to be appropriated to the Commission for this or other purposes.

SEC. 303. IMPROVED SUPERVISION THROUGH STATE AND FEDERAL COOPERATION.

(a) STATE AND FEDERAL RESPONSIBILITIES.—The Investment Advisers Act of 1940 (15 U.S.C. 80b-1 et seq.) is amended by inserting after section 203 the following new section:

15 USC 80b-3a.

"**SEC. 203A. STATE AND FEDERAL RESPONSIBILITIES.**

"(a) ADVISERS SUBJECT TO STATE AUTHORITIES.—

"(1) IN GENERAL.—No investment adviser that is regulated or required to be regulated as an investment adviser in the State in which it maintains its principal office and place of business shall register under section 203, unless the investment adviser—

"(A) has assets under management of not less than $25,000,000, or such higher amount as the Commission may, by rule, deem appropriate in accordance with the purposes of this title; or

"(B) is an adviser to an investment company registered under title I of this Act.

"(2) DEFINITION.—For purposes of this subsection, the term 'assets under management' means the securities portfolios with respect to which an investment adviser provides continuous and regular supervisory or management services.

"(b) ADVISERS SUBJECT TO COMMISSION AUTHORITY.—

"(1) IN GENERAL.—No law of any State or political subdivision thereof requiring the registration, licensing, or qualification as an investment adviser or supervised person of an investment adviser shall apply to any person—

"(A) that is registered under section 203 as an investment adviser, or that is a supervised person of such person, except that a State may license, register, or otherwise qualify any investment adviser representative who has a place of business located within that State; or

"(B) that is not registered under section 203 because that person is excepted from the definition of an investment adviser under section 202(a)(11).

"(2) LIMITATION.—Nothing in this subsection shall prohibit the securities commission (or any agency or office performing like functions) of any State from investigating and bringing enforcement actions with respect to fraud or deceit against an investment adviser or person associated with an investment adviser.

"(c) EXEMPTIONS.—Notwithstanding subsection (a), the Commission, by rule or regulation upon its own motion, or by order upon application, may permit the registration with the Commission of any person or class of persons to which the application of subsection (a) would be unfair, a burden on interstate commerce, or otherwise inconsistent with the purposes of this section.

"(d) FILING DEPOSITORIES.—The Commission may, by rule, require an investment adviser—

"(1) to file with the Commission any fee, application, report, or notice required by this title or by the rules issued under this title through any entity designated by the Commission for that purpose; and

"(2) to pay the reasonable costs associated with such filing.

"(e) STATE ASSISTANCE.—Upon request of the securities commissioner (or any agency or officer performing like functions) of any State, the Commission may provide such training, technical assistance, or other reasonable assistance in connection with the regulation of investment advisers by the State.".

(b) ADVISERS NOT ELIGIBLE TO REGISTER.—Section 203 of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3) is amended—

(1) in subsection (c), in the matter immediately following paragraph (2), by inserting "and that the applicant is not prohibited from registering as an investment adviser under section 203A" after "satisfied"; and

(2) in subsection (h), in the second sentence—

(A) by striking "existence or" and inserting "existence,"; and

(B) by inserting "or is prohibited from registering as an investment adviser under section 203A," after "adviser,".

(c) DEFINITION OF "SUPERVISED PERSON".—Section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)) is amended—

(1) by striking "requires—" and inserting "requires, the following definitions shall apply:"; and

(2) by adding at the end the following new paragraph:

"(25) 'Supervised person' means any partner, officer, director (or other person occupying a similar status or performing similar functions), or employee of an investment adviser, or other person who provides investment advice on behalf of the investment adviser and is subject to the supervision and control of the investment adviser.".

(d) CONFORMING AMENDMENT.—Section 203(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3(a)) is amended by striking "subsection (b) of this section" and inserting "subsection (b) and section 203A".

SEC. 304. INTERSTATE COOPERATION

Section 222 of the Investment Advisers Act of 1940 (15 U.S.C. 80b-18a) is amended to read as follows:

"SEC. 222. STATE REGULATION OF INVESTMENT ADVISERS.

"(a) JURISDICTION OF STATE REGULATORS.—Nothing in this title shall affect the jurisdiction of the securities commissioner (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this title or the rules and regulations thereunder.

"(b) DUAL COMPLIANCES PURPOSES.—No State may enforce any law or regulation that would require an investment adviser to maintain any books or records in addition to those required under the laws of the State in which it maintains its principal place of business, if the investment adviser—

"(1) is registered or licensed as such in the State in which it maintains its principal place of business; and

"(2) is in compliance with the applicable books and records requirements of the State in which it maintains its principle place of business.

"(c) LIMITATION ON CAPITAL AND BOND REQUIREMENTS.—No State may enforce any law or regulation that would require an investment adviser to maintain a higher minimum net capital or to post any bond in addition to any that is required under the laws of the State in which it maintains its principal place of business, if the investment adviser—

"(1) is registered or licensed as such in the State in which it maintains its principal place of business; and

"(2) is in compliance with the applicable net capital or bonding requirements of the State in which it maintains its principal place of business.

"(d) NATIONAL DE MINIMIS STANDARD.—No law of any State or political subdivision thereof requiring the registration, licensing, or qualification as an investment adviser shall require an investment adviser to register with the securities commissioner of the State (or any agency or officer performing like functions) or to comply with such law (other than any provision thereof prohibiting fraudulent conduct) if the investment adviser—

"(1) does not have a place of business located within the State; and

"(2) during the preceding 12-month period, has had fewer than 6 clients who are residents of that State.".

SEC. 305. DISQUALIFICATION OF CONVICTED FELONS.

(a) AMENDMENT.—Section 203(e) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3(e)) is amended—

(1) by redesignating paragraphs (3) through (7) as paragraphs (4) through (8), respectively; and

(2) by inserting after paragraph (2) the following new paragraph:

"(3) has been convicted during the 10-year period preceding the date of filing of any application for registration, or at any time thereafter, of—

"(A) any crime that is punishable by imprisonment for 1 or more years, and that is not described in paragraph (2); or

"(B) a substantially equivalent crime by a foreign court of competent jurisdiction.".

(b) CONFORMING AMENDMENTS.—Section 203 of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3) is amended—

(1) in this subsection (e)(6) (as redesignated by subsection (a) of this section), by striking "this paragraph (5)" and inserting "this paragraph";

(2) in subsection (f)—

(A) by striking "paragraph (1), (4), (5), or (7) of subsection (e) of this section" and inserting "paragraph (1), (5), (6), or (8) of subsection (e)";

(B) by striking "paragraph (3)" and inserting "paragraph (4)"; and

(C) by striking "said subsection" each place that term appears and inserting "subsection"; and

(3) in subsection (i)(1)(D), by striking "section 203(e)(5) of this title" and inserting "subsection (e)(6)".

15 USC 80b-10 note.

SEC. 306. INVESTOR ACCESS TO INFORMATION.

The Commission shall—

(1) provide for the establishment and maintenance of a readily accessible telephonic or other electronic process to

receive inquiries regarding disciplinary actions and proceedings involving investment advisers and persons associated with investment advisers; and

(2) provide for prompt response to any inquiry described in paragraph (1).

15 USC 80b-3a note.

SEC. 307. CONTINUED STATE AUTHORITY

(a) PRESERVATION OF FILING REQUIREMENTS.—Nothing in this title or any amendment made by this title prohibits the securities commission (or any agency or office performing like functions) of any State from requiring the filing of any documents filed with the Commission pursuant to the securities laws solely for notice purposes, together with a consent to service of process and any required fee.

(b) PRESERVATION OF FEES.—Until otherwise provided by law, rule, regulation, or order, or other administrative action of any State, or any political subdivision thereof, adopted after the date of enactment of this Act, filing, registration, or licensing fees shall, notwithstanding the amendments made by this title, continue to be paid in amounts determined pursuant to the law, rule, regulation, or order, or other administrative action as in effect on the day before such date of enactment.

(c) AVAILABILITY OF PREEMPTION CONTINGENT ON PAYMENT OF FEES.—

(1) IN GENERAL.—During the period beginning on the date of enactment of this Act and ending 3 years after that date of enactment, the securities commission (or any agency or office performing like functions) of any State may require registration of any investment adviser that fails or refuses to pay the fees required by subsection (b) in or to such State, notwithstanding the limitations on the laws, rules, regulations, or orders, or other administrative actions of any State, or any political subdivision thereof, contained in subsection (a), if the laws of such State require registration of investment advisers.

(2) DELAYS.—For purposes of this subsection, delays in payment of fees or underpayments of fees that are promptly remedied in accordance with the applicable laws, rules, regulations, or orders, or other administrative actions of the relevant State shall not constitute a failure or refusal to pay fees.

15 USC 80b-2 note.

SEC. 308. EFFECTIVE DATE.

(a) IN GENERAL.—This title and the amendments made by this title shall take effect 180 days after the date of enactment of this Act.

(b) CONFORMING AMENDMENT.—

(1) IN GENERAL.—Section 3(38)(B) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002(38)(B)) is amended by inserting "or under the laws of any State" after "1940".

29 USC 1002 note.

(2) SUNSET.—The amendment made by paragraph (1) shall cease to be effective 2 years after the date of enactment of this Act.

Calendar No. 468

104TH CONGRESS *2d Session* | SENATE | REPORT No. 104-293

THE SECURITIES INVESTMENT PROMOTION ACT OF 1996

JUNE 26, 1996.– Ordered to be printed

Mr. D'AMATO, from the Committee on Banking, Housing, and Urban Affairs, submitted the following

R E P O R T

[To accompany S. 1815]

INTRODUCTION

On June 19, 1996, the Senate committee on Banking, Housing, and Urban Affairs met in legislative session and marked up and ordered to be reported S. 1815, a bill to improve regulation of the securities markets, reduce costs of investing, and for other purposes, with a recommendation that the bill do pass, with an amendment in the nature of a substitute. The Committee's action was taken by a vote of 16 in favor and none opposed.

HISTORY OF THE LEGISLATION

The Securities Investment Promotion Act of 1996, S. 1815, was introduced on May 23, 1996, by Senators Gramm, D'Amato, Dodd, Bryan, and Moseley-Braun. Senators Mack and Bennett were added as cosponsors in the days following. The legislation builds upon two bills previously introduced in the Senate, one of which was adopted by the Senate during the 103rd Congress. Title I of the bill is a revised and updated version of S. 148, the Investment Advisers Integrity Act, introduced on January 4, 1995 by Senator Gramm. Sections 301 through 306 of the bill are drawn from the Small Business Incentive Act of 1993, S. 479 which was introduced on March 2, 1993, by Senators Dodd, D'Amato, Kerry, Bryan, Mack, Domenici, and others, approved by the committee on September 21, 1993, and adopted by the Senate by a voice vote on November 2, 1993. Section 207 builds upon a concept also contained in S. 479.

The full Committee conducted a legislative hearing on S. 1815 on June 5, 1996. Testimony was received from the Honorable Arthur Levitt, Jr., Chairman of the Securities and Exchange Commission ("SEC" or "Commission"); Christopher W. Brody, Partner, Warburg Pincus & Company, on behalf of the National Venture Capital Association; Matthew Fink, President of the Investment Company Institute; Dee R. Harris, Director, Division of Securities, Arizona Corporation Commission, and President of the North American Securities Administrators Association ("NASAA"), on behalf of NASAA; A.B. Krongard, Chairman and Chief Executive Officer, Alex Brown & Sons, and Chairman of the Securities Industry Association ("SIA"), on behalf of the SIA; Paul Saltzman, Senior Vice President and General Counsel, Public Securities Association; and Mark D. Tomasko, Executive Vice President, Investment Counsel Association of America.

Additional comments, suggestions, and assistance in considering and evaluating the legislation were received from State regulators, staff of the SEC, trade associations, and numerous other private and public individuals. This broad input was essential in the Committee's efforts to produce legislation that enjoys wide public support and consensus within the Committee.

PURPOSE AND SUMMARY

The purpose of this legislation was evidenced by SEC Chairman Levitt in his testimony before the Committee: "The current system of dual federal-state regulation is not the system that Congress—or the Commission—would create today if we were designing a new system * * * An appropriate balance can be attained in the federal-state arena that better allocates responsibilities, reduces compliance costs and facilitates capital formation, while continuing to provide for the protection of investors. The bill's approach to the division of responsibilities in the investment adviser and investment company areas exemplifies such a balance."

While the bill makes amendments to four separate federal securities statutes (the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act, of 1940, and the Investment Advisers Act of 1940) its key provisions, taken together, focus on the need to delineate more clearly the securities law responsibilities of the federal and state governments. Currently, that relationship is a confusing, conflicting, and involves a degree of overlap that may raise costs unnecessarily for American investors and the members of the securities industry. The Committee believes that the reforms in this bill will enhance investor protection while reducing the costs of investing.

Title I of the bill creates a clear division of labor between the states and the federal government for supervision of investment advisers. Currently, while investment advisers are nominally supervised by the SEC and by most states, both are overwhelmed by the size of the task, with more than 22,000 investment advisers currently registered with the SEC. The reality has been that while investment advisers may boast of their registration with the SEC, the SEC has been unable to conduct active supervision of more

than a fraction of the advisers registered with the Commission.[1] State securities commissioners have similarly found their resources spread thin. Title I would improve supervision by focusing SEC supervision on investment advisers most likely to be engaged in interstate commerce and focusing state supervision on advisers whose activities are most likely to be centered in their home state.

Title II of the bill recognizes the need to reform the Investment Company Act in keeping with changing technologies and market and investing conditions. Taken together, these provisions will reduce the regulatory costs borne by the investment companies, facilitate the ability of investment companies to share timely information with investors, broaden investor choices, and have the effect of further promoting saving and investing in the economy.

Title III contains a number of additional provisions to reduce the cost of saving and investment. Perhaps most significant are provisions that would recognize and strengthen the national markets for mutual funds and stocks. Many mutual funds are traded in a truly national market, today they are still subject to standards set by as many as fifty-two different government authorities. The bill would apply one national standard for registration of securities that trade in a national securities market. At the same time, the bill preserves the legitimate role of the states to enforce their laws against fraudulent actions. Each of the provisions of this Title would remove or reform regulations and regulatory practices and conditions that are outmoded or otherwise serve neither investors nor the companies that employ capital for the creation of jobs and economic growth and opportunity in the United States.

IMPROVED REGULATION OF INVESTMENT ADVISERS

The problem: overlapping responsibilities prevent the best use of resources for adequate supervision

Today there are approximately 22,500 investment advisers registered with the Securities and Exchange Commission. The number of registered investment advisers has increased by over 500% since 1980, far outstripping the growth in the Commission's examination resources. As a result, smaller investment advisers are now examined, on average, once every 44 years—amounting to virtually no regulation at all.[2]

The Committee is concerned about the lack of adequate oversight of the growing number of investment advisers and the impact inadequate regulation may have on investors and American consumers. This is particularly troublesome since many investment advisers hold themselves out to the public as "REGISTERED WITH THE SEC," a statement that may give investors a false sense of confidence—particularly if the investment adviser has never actually been inspected by the SEC and is in little danger of any imminent inspection.

Recognizing the limited resources of both the Commission and the states, the Committee believes that eliminating overlapping

[1] Testimony of Arthur Levitt, Chairman of the U.S. Securities and Exchange Commission concerning S. 1815, the "Securities Investment Promotion Act of 1996," before the Committee on Banking, Housing, and Urban Affairs, June 5, 1996 at Appendix A, p.2.
[2] Id.

regulatory responsibilities will allow the regulators to make the best use of their scarce resources to protect clients of investment advisers. The states should play an important and logical role in regulating small investment advisers whose activities are likely to be concentrated in their home state. Larger advisers, with national businesses, should be registered with the Commission and be subject to national rules.

The solution: dividing regulatory responsibility

The legislation allows states to assume the primary role with respect to regulating advisers that are small, local businesses, managing less than $25 million in client assets, while the Commission's role is focused on larger advisers with $25 million or more in client assets under management. The Commission will continue to supervise all advisers that are based in a state that does not register investment advisers.

Investment advisers registered with the states will no longer have to register with the SEC. Investment advisers registered with the SEC will no longer have to register with the states but will continue to pay fees to the states. State regulators will enforce books and records and financial responsibility laws for investment advisers registered in their state. Both the Commission and the states will be able to continue bringing anti-fraud actions against investment advisers regardless of whether the investment adviser is registered with the state or the SEC.

Based on data filed with the Commission, this regulatory scheme will leave states with primary responsibility for over 16,000 investment advisers (or almost 72% of Commission registrants) and the Commission responsibility for the remaining 6,300 or so investment advisers. Significantly, those 6,300 investment advisers manage assets totaling approximately 95% of the almost $8 trillion currently overseen by investment advisers—allowing the Commission to concentrate its resources on investment advisers with a national businesses.[3] [sic]

The Committee preempts state registration of Commission-registered advisers as well as advisers that are specifically excepted from the definition of investment adviser. Persons who are supervised by advisers registered with the Commission are also preempted from state registration. A "supervised person" includes employees or independent contractors of the investment adviser who are supervised and controlled by the investment adviser and who provide investment advice on its behalf.[4]

The bill generally exempts investment advisers who manage less than $25 million from SEC registration, but provides for some flexibility by giving the Commission authority to grant exemptions from the prohibition. The SEC may except from state registration those advisers for whom registration would be "unfair" or a "burden on interstate commerce." The SEC may similarly make exemptions from SEC registration.

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[3] Id.

[4] The Internal Revenue Service should not base an individual's status as an employee or independent contractor solely on an entity's requirement to supervise that individual under the federal securities laws.

The Committee recognizes that the definition of "assets under management" requires that there be continuous and regular supervisory or management services—a standard which may, in some cases, exclude firms with a national or multistate practice from being able to register with the SEC. The Committee intends the Commission to use its exemptive authority to permit, where appropriate, the registration of such firms with the Commission. The Commission should also use the exemptive authority to address circumstances in which an adviser temporarily does not have $25 million under management. Theses examples do not serve to limit the SEC's exemptive authority, but merely to illustrate situations the SEC should address promptly.

The SEC may also use its exemptive authority under the bill to raise the $25 million threshold higher as it deems appropriate in keeping with the purposes of the Investment Advisers Act. In testimony before the Committee, Dee R. Harris, testifying on behalf of the NASAA, suggested that the SEC review the appropriateness of that threshold at least every three years. The Committee concurs with NASAA's view on this and recommends it to the SEC. As guidance in the review process, the SEC may want to consider (1) the total number of investment advisers; (2) their geographical locations; (3) their methods of operation; and (4) their methods of operation. The SEC may also want to seek comments from investment advisers, financial planners, state regulators, and other interested parties.

Other improvements to investment adviser regulation

The new regulatory approach envisioned should encourage the state regulators and the SEC to create a uniform filing system for "one stop" filings. A uniform filing system would benefit investors, reduce regulatory and paperwork burdens for registered investment advisers and facilitate supervisory coordination between the states and the SEC.

The Investment Advisers Act now permits the Commission to bar certain individuals who have been convicted of specific crimes primarily involving financial matters or theft from serving as investment advisers. The current limits of the statute create a perverse situation where the SEC can bar an embezzler from the advisory industry, but not a convicted murderer or drug dealer. In a few cases, the Commission has had some difficulty in keeping an obviously unfit felon from registering as an investment adviser. The Committee believes that unfit felons should not be entrusted with the responsibility of giving investment advice and managing client assets. Therefore, the Committee gives the SEC new authority to deny or withdraw the registration of any person convicted of a felony (or of any adviser associated with such a person) to eliminate this problem.

IMPROVING REGULATION OF AND SIMPLFYING RULES FOR MUTUAL FUNDS

Background

Over 30 million U.S. households—about one in three families—now own an aggregate of approximately $2.7 trillion in mutual

ests may legitimately be transferred. First, interests in a qualified purchaser pool received through a gift, bequest or other involuntary action are deemed to be made to qualified purchasers—even if the recipient does not otherwise meet the definition of qualified purchaser. Second, trusts in which only qualified purchasers have contributed assets are also deemed to be qualified purchasers.

Commodity Pools and Commodity Trading Advisers

The Committee has not included a provision addressing the need for exemptive relief under the Investment Company Act and the Investment Advisers Act for commodity pools and commodity trading advisers. [8] The Committee understands, however, that limited relief exists but has shown to be unduly restrictive. The SEC staff has indicated a willingness to consider and take action to give commodity pools and commodity trading advisers further administrative relief. The Committee expects the SEC staff to consider and, where appropriate, to take action to effect such administrative relief as soon as practicable following enactment of this legislation.

Performance fees

The Investment Advisers Act generally prohibits a registered investment adviser from receiving compensation on the basis of a share of capital gains in or capital appreciation of a client's account. Commonly referred to as performance-based compensation or a "performance fee," this type of compensation arrangement can take various forms. For example, a fee equaling 10% of an account's gains or a fee of 20% of all the gains in an account exceeding the performance of a designated securities index or other benchmark would be a performance fee.

Originally, performance fees were prohibited out of concern that they created incentives for advisers to take undue risks in managing a client's account in order to increase advisory fees. In 1970, Congress concluded that performance fees were not necessarily undesirable in all cases and exempted from the performance fee prohibition a type of fee known as a "fulcrum fee." Investment advisers may enter into fulcrum fee arrangements with registered investment companies or persons with at least $1 million in assets. Commission rules also provide a limited exemption from the prohibition for advisory contracts with clients having at least $500,000 under management or a net worth exceeding $1 million.

The Committee believes that investors in a qualified purchaser pool are sophisticated enough to be allowed to enter into a fee arrangement that is not a fulcrum fee. In addition, advisers should be permitted to enter into performance fee contracts with their foreign clients when such arrangements are legal and customary in a client's country of residence. S. 1815 eliminates the competitive disadvantage experienced by U.S. investment advisers by allowing them to enter into customary performance fee arrangements with foreign clients. The bill also gives the SEC greater flexibility to exempt from the performance fee prohibition advisory contracts with

[8] Generally, "commodity pools" refer to issuers that primarily engaged in the business of operating a commodity pool or investing in interests of such pools and "commodity adviser" refers to those individuals who trade or give trading advice on commodity interests.

institutional clients that can appreciate the risks and are in a position to protect themselves from overreaching by the adviser.

OPENING THE CAPITAL MARKETS FOR SMALL BUSINESS

The "Small Business Incentive Act"

The Committee believes that small business is the engine of economic growth and remains interested in finding ways to open up the capital markets to small business. The provisions of the bill based on the "Small Business Incentive Act" enhance small business access to credit by making it easier for certain types of companies to raise capital and promote investments in small business. These provisions were considered and passed by the Senate during the 103rd Congress.

Exemption for economic, business and industrial development companies

State-chartered economic, business or industrial development companies that provide capital, investment and managerial assistance to small projects and businesses will no longer have to register with the SEC under the Investment Company Act if they meet two conditions. First, the company must be limited to promoting economic, business, or industrial development in the state in which the company is organized. Second, the company could not issue redeemable securities and must sell at least 80% of its securities to "accredited investors" residing in the state where the company is organized.

The Committee believes these companies perform an important local function—stimulating local economies by providing direct investment and loan financing, as well as managerial assistance, to different types of state and local enterprises—and should be regulated at the state level, not the federal level. States have a strong interest in these companies' operations. To qualify for the proposed exemption, a company would have to be regulated under a specific state statute and organized under the laws of that state.[9] Because some state statutes provide comprehensive regulation, while others are less substantive, the bill authorizes the SEC to supplement state provisions when necessary to respond to investor protection concerns.

Exemption for intrastate closed-end investment company

The Commission currently may exempt intrastate closed-end fund from some or all of the Investment Company Act's provisions if the aggregate proceeds of completed and proposed offerings do not exceed $100,000. This limit was set in 1940 and never has been changed. To reflect the capital needs of intrastate funds in today's financial market, the bill increases the aggregate offering amount to $10 million or such other amount as the SEC may set by rule or order.

Business Development Companies

Business development companies or "BDCs," are closed-end funds that invest in small and developing businesses. BDCs differ

[9] Forty-five states now have statutes specifically authorizing the creation of these companies.

tee notes that there has been no formal study on shareholder proposals. The bill, therefore, directs the Commission to undertake a comprehensive year-long review of shareholder proposals, focusing on whether shareholders should be able to raise through the proxy process concerns about corporate employment practices, or other business practices, that raise broader social and public policy issues, such as discrimination. The bill further directs the Commission to prepare recommendations on how it plans to improve shareholder access to proxy statement through the SEC's rulemaking process.

"Preferencing"

Preferencing refers to a trading method for stock exchanges that may be inconsistent with the concept of a traditional auction market. Preferencing permits a customer's brokerage firm to trade directly with its customers rather than interact with other customer orders. The brokerage firm acts as a dealer with its own customers, capturing the price difference for itself. The Committee has concerns about the impact of preferencing on retail securities customers. Consequently, the bill directs the SEC to determine and report within six months on the impact of preferencing on: (1) the execution price received by retail securities customers whose orders are preferenced; (2) the ability of retail securities customers in all markets to obtain execution of limit orders in preferenced securities; and (3) the cost of preferencing to retail customers.

SECTION-BY-SECTION ANALYSIS OF S. 1815: THE "SECURITIES INVESTMENT PROMOTION ACT OF 1996"

Section 1. Short title; table of contents

Section 1 provides that S. 1815 may be cited as the "Securities Investment Promotion Act of 1996" (the "Act") and sets out a table of contents for the Act.

Section 2. Severability

Section 2 provides that, if some part of the Act is held to be unconstitutional, the remainder of the Act will not be affected.

TITLE I—INVESTMENT ADVISERS SUPERVISION COORDINATION ACT

Section 101. Short title

Section 101 provides that Title I may be cited as the "Investment Advisers Supervision Coordination Act."

Section 102. Funding for enhanced enforcement priority

Section 102 authorizes up to $16 million of the SEC's budget for fiscal years 1997 and 1998 to be earmarked for enforcement of the Investment Advisers Act of 1940.

Section 103. Improved supervision through State and Federal cooperation

Section 103(a) adds a new section 203A to the Investment Advisers Act of 1940 (the "Advisers Act") dividing regulatory responsibility for investment advisers between the States and the SEC.

New Section 203A provides that investment advisers who manage $25 million (or a higher amount set by the Commission) or more in client assets or who advise a mutual fund or business development company or whose state does not register investment advisers will have to register with the SEC. Other investment advisers will have to register only with the State in which the adviser maintains its principal place of business. The SEC will continue to regulate investment advisers located in states that do not require investment advisers to register.

This section defines "assets under management" to mean securities portfolios over which the adviser provides "continuous and regular supervisory or management services."

New section 23A(b) prohibits a State from subjecting to State registration, licensing or qualification requirements: (1) SEC registered investment advisers and their "supervised persons," and (2) persons who are specifically excepted from the definition of an investment adviser. A "supervised person" includes an employee or independent contractor of an investment adviser who provide investment advice on behalf of and is supervised by the investment adviser.

New section 23A(b) also permits a State to require investment advisers to file with it documents required to be filed with the SEC or "notice" documents relating to an investment advisers' employees. This section also makes clear that the SEC and the States retain their authority to pursue actions against investment advisers for "fraud or deceit."

New section 23A(c) allows the SEC flexibility to determine that certain investment advisers should be permitted to register with the SEC (even if the adviser does not manage $25 million or more in client assets) if denying SEC registration would be "unfair, a burden on interstate commerce, or otherwise inconsistent with the purposes of this section."

Section 104. Interstate cooperation

Section 104 amends section 222 of the Advisers Act, establishing that states may only enforce books and records and financial responsibility standards, as established [sic] the state in which the investment adviser maintains its principal place of business.

Section 105. Disqualification of convicted felons

Section 105 amends section 203(e) of the Advisers Act, allowing the SEC to deny or withdraw the registration of an investment adviser convicted of a felony within the previous ten years.

Section 106. Effective date

This section becomes effective 180 days after enactment of the "Investment Advisers Supervision Coordination Act."

TITLE II—FACILITATING INVESTMENT IN MUTUAL FUNDS

Section 201. Short title

Section 201 provides that Title II may be cited as the "Investment Company Act Amendments of 1996."

igible for consideration in satisfying the $5 and $25 million qualified purchaser investment tests. The Committee expects, however, that the SEC would define "investments" to include assets held for investment purposes. The Committee does not anticipate or recommend the inclusion, for example, of a controlling interest in a privately-owned family business or a personal residence.

Section 207(d)(3) requires the SEC to adopt rules within one year rules permitting knowledgeable employees of an issuer or affiliated person to own securities of a section 3(c)(1) or 3(c)(7) fund.

Section 208. Performance fee exemptions

Section 208 amends section 205 of the Investment Advisers Act, excepting investment advisory contracts with qualified purchaser pools from the Act's prohibition on performance fees. Section 208 also amends section 205 to give the SEC explicit authority to exempt from the performance fee prohibition investment advisory contracts with sophisticated clients and clients that are not residents of the United States.

Section 209. Reports to the Commission and shareholders

Section 209 amends section 30(b)(1) and (c) of the Investment Company Act, granting the SEC authority to require more frequent reporting of current information. Right now, section 30(b)(1) allows the SEC to require investment companies to file information and document "to keep reasonably current the information and documents contained in the registration statement" but no more frequently than semi-annually or quarterly.

This provision removes the limitations on how often the SEC may require information. In exercising this expanded authority, however, the SEC must minimize the compliance burdens on registered investment companies and their affiliates as set out in new section 30(c)(1) of the Investment Company Act.

Section 209 also adds a new subsection (f) to section 30 of the Investment Company Act, allowing the SEC to require investment companies to report additional information in its report to shareholders. This provision expands the SEC's current authority, which extends only to the contents of financial statements. New section 30(f) also requires the SEC to minimize the compliance burdens on registered investment companies and their affiliates as set out in new section 30(c)(1) of the Investment Company Act.

Section 210. Books, records, and inspections

Section 210 amends section 31 (a) and (b) and adds a new subsection (c) to the Investment Company Act, expanding the SEC's record keeping authority under that Act. This provision enables the SEC to specify the information that must be included in an investment company's records.

Section 31(a), as amended, authorizes the SEC to require registered investment companies and certain of their related entities to maintain *any* records "necessary or appropriate in the public interest or for the protection of investors." This section references the definition of "records" already contained in section 3(a)(37) of the Securities Exchange Act of 1934 (the "Securities Exchange Act") to

calculation of the minimum market capitalization necessary to qualify to use the form for a primary offering.

Section 315. Church employee pension plans

Section 315 exempts from most federal securities regulation any church employee pension plan described in section 414(e) of the Internal Revenue Code of 1986 (the "Code") if, under the plan, no part of the assets may be diverted to purposes other than the exclusive benefit of employees.

Section 315(a) amends section 3(c) of the Investment Company Act by adding a new paragraph 14, excepting church employee pension plans ("Church Plans") from the registration, reporting and other regulatory requirements of that Act.

Section 315(b) amends section 3(a) of the Securities Act by adding a new paragraph 13, exempting interests in Church Plans from registration under that Act.

Section 315(c) amends section 3 of the Securities Exchange Act to include within the definition of exempted securities (but only for purposes of section 12, 13, 14, and 16 of the Securities Exchange Act) any securities issued by, or interests in, Church Plans. As a result, Section 315(c) exempts church plans and the person associated with such plans, from the requirements of the Securities Exchange Act that directly impact them. This section also adds a new subsection (f) to section 3 of the Securities Exchange Act, specifically providing that church plans, and the trustees, directors, officially providing that church plans, and the trustees, directors, officers, employees, or volunteers for such plans, would not be deemed "broker-dealers" if their only securities activities are on behalf of such plans and they do not receive any commission or other transaction-related compensation. The antifraud provisions of the federal securities laws would continue to apply to interests in church plans.

Section 315(d) amends section 203(b) of the Investment Advisers Act by adding a new paragraph 5, exempting churches, church pension boards, and the internal personnel from registration as investment advisers under the Investment Advisers Act. This section also exempts from regulation any company or account that is established by a person eligible to establish a Church Plan if substantially all of its activities relate to managing the assets of, or providing benefits under, exempt Church Plans.

Section 315(e) amends section 304(a)(4)(A) of the Trust Indenture Act to include the securities exempted from the provisions of the Trust Indenture Act any security issued by, or any interest or participation in, any exempt Church Plans.

Section 315(f) exempts Church Pans from certain State securities laws relating to: (1) registration and qualification of securities; (2) investment company registration and regulation; and (3) broker-dealer registration and regulation.

This section establishes certain notice provisions to ensure that plan participants and the SEC are aware of a plan's existence and its exempt status. Section 315(g) amends the Investment Company Act by adding new subsection (g) to section 30, requiring Church plans to notify the exempt plan participants that the plan is not subject to and the participants are not covered by registration, regulation, or reporting requirements under the Investment Company

Based on information from the agency, CBO estimates that preparation of an estimated 50 reports in each fiscal year would cost the agency about $1 million annually. For fiscal years 1997 and 1998, the cost of preparing such reports would be covered by the authorization of appropriations of $6 million for the Economic Analysis Program. In each of fiscal years 1999 to 2002, CBO estimates additional discretionary spending of $1 million to cover the costs of reports.

Revenues

Investment Advisor's Fee. Under current law, investment advisers are subject to SEC regulations and required to pay a one-time $150 fee to register with the SEC. The SEC estimates that 1,000 to 2,000 investment advisors register each year, for total annual fees of about $225,000. Title I of the bill would exempt investment advisors who manage less than $25 million in client funds from SEC regulation. According to the SEC, about 75 percent of the investment advisors who currently register manage less than $25 million in client funds. Therefore, CBO estimates that enacting Title I of the bill would reduce SEC collections by about $170,000 annually.

Registration Fee. S. 1815 would extend the deadline for investment companies to file registration fees on the net value of mutual funds sold to the public from 60 days to 90 days after the end of a company's fiscal year. CBO estimates that this delay in payments to the SEC would result in a one-time reduction in governmental receipts of about $9 million in fiscal year 1998, because it would shift payments by some companies from fiscal year 1998 to 1999. (CBO estimates that the bill would not affect 1997 receipts because this provision would not take effect until one year after enactment). Similar shifts would occur in subsequent years. Thus, while total receipts from registration fees would remain largely unchanged, there would be a budgetary effect in 1998.

Because companies filing beyond the deadline are subject to higher fees, extending the filing period also could reduce total fee collections. However, the bill would authorize the SEC to collect interest on late payments, and such interest would partially offset any reduction in the amount of delinquent fees. In addition, the bill would simplify the procedures by which registration fees are calculated: that simplification could increase fee collections through greater compliance. CBO estimates that these provisions taken together would not significantly affect the amount of fees collected by the SEC.

7. Pay-as-you-go considerations: Section 252 of the Balanced Budget and Emergency Deficit Control Act of 1985 sets up pay-as-you-go procedures for legislation affecting direct spending or receipts through 1998. CBO estimates that enactment of S. 1815 would affect receipts by extending the due date for certain registration fees and by reducing the number of investment advisors who must register with the SEC and thus pay the requisite fee. Therefore, pay-as-you-go procedures would apply to the bill. The following table summarizes the estimated pay-as-you-go impact of S. 1815.

Preemption of State Registration Requirements for Securities. The bill would preempt state laws requiring the registration or qualification of certain categories of securities and certain securities transactions. The bill provides, however, that states may require the filing of documents filed with the SEC together with any required fee. It further provides that states may continue to collect filing or registration fees pursuant to state laws in effect prior to the enactment of S. 1815. CBO estimates that these fees currently generate revenues for the states totaling $210 million to $240 million annually, and that this bill would not preclude the collection of such fees.

There is, however, some uncertainty as to whether these fee collections would continue uninterrupted in all states if S. 1815 is enacted. The North American Securities Administrators Association (NASAA) and several state securities regulators have expressed concern that if S. 1815 were enacted some states, because of the construction of their own statues, would not be above to withstand legal challenges to their right to collect current fees. However, CBO believes that because the scope of the federal preemption in S. 1815 is limited, any loss of revenues would not be a direct cost of a federal mandate as defined in Public law 104-4.

By prohibiting states from registering investment company offerings or reviewing disclosure documents, the bill would produce administrative savings for those states that currently devote staff resources to those tasks. In our survey of state securities regulators, however, CBO found that only about a dozen states actively review and comment on disclosure documents, and that only a few staff members in each state were assigned to those tasks. Therefore, we estimate that the administrative savings to states would not significantly offset revenue losses from other mandates in the bill.

Partial Preemption of State Requirements for Investment Advisers. S. 1815 would partially preempt state laws requiring the registration, licensing, or qualification of investment adviser firms and their employees. Firms that manage more than $25 million in client assets or who advise an investment company or business development company would have to register with the SEC but would be exempt from similar state requirements. These firms' employees or independent contractors would also be exempt from state registration, licensing, and qualification requirements. According to NASAA, 46 states currently register investment adviser firms and 30 states license or register these firms' employees.

As with registration fees for securities, the bill provides that states may require the filing of documents filed with the SEC together with any required fee, and further provides that states may continue to collect filing or registration fees pursuant to state laws in effect prior to the enactment of S. 1815. There is some uncertainty as to whether these fee collections would continue uninterrupted in all states if S. 1815 is enacted. Again, CBO believes that because the scope of this federal preemption is limited, any loss of revenues would not be a direct cost of a federal mandate as defined in public Law 104-4.

9. Estimated impact on the private sector: CBO has identified four private-sector mandates in this bill. We expect that these mandates would not impose any significant costs on the private

sector. One mandate would impose requirements on examining authorities, also referred to as self-regulating organizations (SROs), such as the New York Stock Exchange and the American Stock Exchange, while the remaining three would impose requirements on investment advisors., investment companies, and certain related entities.

To eliminate duplicate and overlapping examinations, the first mandate would require that the SROs and the SEC coordinate the examination process for the brokers and dealers that are subject to more than one examining authority. Based on information provided by the SEC and the SROs, CBO concludes that the SROs would not incur any additional costs because they are already coordinating the examination process with the SEC.

The other mandates affect larger investment advisors, investment companies, and certain related entities. The bill would allow the SEC to require larger investment advisors to file fees, applications, reports, or notices thorough a SEC-designated entity. Based on information from the SEC and industry representatives, CBO concludes that the SEC would require that the larger investment advisors file reports electronically that they currently file in paper form. This information would then be sent to the SEC and the appropriate states. The investment advisors expect to incur only marginal costs and to experience some savings as a result of electronic filing.

The bill would also give the SEC the authority to require investment companies to file information, documents, and reports more frequently, to include additional information in their semi-annual reports, and to maintain other records that are similar to those that the SEC currently requires of investment advisers, brokers, and dealers. The SEC does not anticipate changing current filing and recordkeeping requirements as a result of these provisions. Therefore, CBO estimates that investment companies' costs would not be affected.

10. Previous CBO estimate: On June 6, 1996, CBO prepared cost estimates for H.R. 3005, the Securities Amendments of 1996, as ordered reported by the House Committee on Commerce on May 15, 1996. On June 12, 1996, CBO provided a revised intergovernmental mandates cost estimate for H.R. 3005 to reflect a technical and conforming change to the base text of H.R. 3005 regarding the scope of the preemption of state registration requirements. The impact on the federal budget of the two bills differs primarily because S. 1815 authorizes appropriations for fiscal years 1997 and 1998.

11. Estimate prepared by: Federal Cost Estimate: Rachel Forward and Stephanie Weiner. State and Local Government Impact: Pepper Santalucia. Private-Sector Impact: Jean Wooster.

12. Estimate approved by: Robert A. Sunshine for Paul N. Van de Water, Assistant Director for Budget Analysis.

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104TH CONGRESS
2d Session

HOUSE OF REPRESENTATIVES

REPORT
No. 104-864

NATIONAL SECURITIES MARKETS IMPROVEMENT ACT OF 1996

SEPTEMBER 28, 1996.– Ordered to be printed

Mr. BLILEY, from the committee of conference,
submitted the following

CONFERENCE REPORT

[To accompany H.R. 3005]

The committee of conference on the disagreeing votes of the two Houses on the amendment of the Senate to the bill (H.R. 3005), to amend the Federal securities laws in order to promote efficiency and capital formation in the financial markets, and to amend the Investment Company Act of 1940 to promote more efficient management of mutual funds, protect investors, and provide more effective and less burdensome regulation, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

That the House recede from its disagreement to the amendment of the Senate and agree to do the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment, insert the following:

SECTION 1. SHORT TITLE; TABLE OF CONTENT.

(a) SHORT TITLE.—This Act may be cited as the "National Securities Markets Improvement Act of 1996".

(b) TABLE OF CONTENTS.—The table of contents of this Act is as follows:

(3) EMPLOYEE EXCEPTION.—Not later than 1 year after the date of enactment of this Act, the Commission shall prescribe rules pursuant to its authority under section 6 of the Investment Company Act of 1940 to permit the ownership of securities by knowledgeable employees of the issuer of the securities or an affiliated person without loss of the exception of the issuer under paragraph (1) or (7) of section 3(c) of that Act from treatment as an investment company under that Act.

(4) BENEFICIAL OWNERSHIP.—Not later than 180 days after the date of enactment of this Act, the Commission shall prescribe rules defining the term "beneficial owner" for purposes of section 3(c)(7)(B) of the Investment company Act of 1940, as amended by this Act.

(e) EFFECTIVE DATE.—The amendments made by this section shall take effect on the earlier of--

(1) 180 days after the date of enactment of this Act; or

(2) the date on which the rulemaking required under subsection (d)(2) is completed.

SEC. 210. PERFORMANCE FEES EXEMPTIONS

Section 205 of the Investment Advisers Act of 1940 (15 U.S.C. 80b-5) is amended—

(1) in subsection (b)—

(A) in paragraph (2) by striking "or" at the end;

(B) in paragraph (3) by striking the period at the end and inserting a semicolon; and

(C) by adding at the end the following new paragraphs:

"(4) apply to an investment advisory contract with a company excepted from the definition of an investment company under section 3(c)(7) of title I of this Act; or

"(5) apply to an investment advisory contract with a person who is not a resident of the United States."; and

(2) by adding at the end the following new subsection:

"(e) The Commission, by rule or regulation, upon its own motivation, or by order upon application, may conditionally or unconditionally exempt any person or transaction, or any class or classes of persons or transactions, from subsection (a)(1), if and to the extent that the exemption relates to an investment advisory contract with any person that the Commission determines does not need the protections of subsection (a)(1), on the basis of such factors as financial sophistication, net worth, knowledge of and experience in financial matters, amount of assets under management, relationship with a registered investment adviser, and such other factors as the Commission determines are consistent with this section.".

TITLE III—INVESTMENT ADVISERS SUPERVISION COORDINATION ACT

SEC. 301. SHORT TITLE.

This title may be cited as the "Investment Advisers Supervision Coordination Act".

SEC. 302. FUNDING FOR ENHANCED ENFORCEMENT PRIORITY.

There are authorized to be appropriated to the Commission, for the enforcement of the Investment Advisers Act of 1940, not more than $20,000,000 in each of fiscal years 1997 and 1998, in addition to any funds authorized to be appropriated to the Commission for this or other purposes.

SEC. 303. IMPROVED SUPERVISION THROUGH STATE AND FEDERAL COOPERATION.

(a) STATE AND FEDERAL RESPONSIBILITIES.—The Investment Advisers Act of 1940 (15 U.S.C. 80b—1 et seq.) is amended by inserting after section 203 the following new section:

"SEC. 203A. STATE AND FEDERAL RESPONSIBILITIES.

"(a) ADVISERS SUBJECT TO STATE AUTHORITIES.—

"(1) IN GENERAL.—No investment adviser that is regulated or required to be regulated as an investment adviser in the State in which it maintains its principal office and place of business shall register under section 203, unless the investment adviser—

"(A) has assets under management of not less than $25,000,000, or such higher amount as the Commission may, by rule, deem appropriate in accordance with the purposes of this title; or

"(B) is an adviser to an investment company registered under title I of this Act.

"(2) DEFINITION.—For purposes of this subsection, the term 'assets under management' means the securities portfolios with respect to which an investment adviser provides continuous and regular supervisory or management services.

"(1) IN GENERAL.—No law of any State or political subdivision thereof requiring the registration, licensing, or qualification as an investment adviser or supervised person of an investment adviser shall apply to any person—

"(A) that is registered under section 203 as an investment adviser, or that is a supervised person of such person, except that a State may license, register, or otherwise qualify any investment adviser representative who has a place of business located within that State; or

"(B) that is not registered under section 203 because that person is excepted from the definition of an investment adviser under section 202(a)(11).

"(2) LIMITATION.—Nothing in this subsection shall prohibit the securities commission (or any agency or office performing like functions) of any State from investigating and bringing enforcement actions with respect to fraud or deceit against an investment adviser or person associated with an investment adviser.

"(c) EXEMPTIONS.—Notwithstanding subsection (a), the Commission, by rule or regulation upon its own motion, or by order upon application, may permit the registration with the Commission of any person or class of persons to which the application of subsection (a) would be unfair, a burden on interstate commerce, or otherwise inconsistent with the purposes of this section.

"(d) FILING DEPOSITORIES.—The Commission may, by rule, require an investment adviser—

"(1) to file with the Commission any fee, application, report or notice required by this title or by the rules issued under this title through any entity designated by the Commission for that purpose; and

"(2) to pay the reasonable costs associated with such filing.

"(e) STATE ASSISTANCE.—Upon request of the securities commissioner (or any agency or officer performing like functions) of any State, the Commission may provide such training, technical assistance , or other reasonable assistance in connection with the regulation of investment advisers by the State.".

(b) ADVISERS NOT ELIGIBLE TO REGISTER.—Section 203 of the Investment Advisers Act of 1940 (15 U.S.C. 80b—3) is amended—

(1) in subsection (c), in the matter immediately following paragraph (2), by inserting "and that the applicant is not prohibited from registering as an investment adviser under section 203A" after "satisfied"; and

(2) in subsection (h), in the second sentence—

(A) by striking "existence or" and inserting "existence,"; and

(B) by inserting "or is prohibited from registering as an investment adviser under section 203(A)," after "adviser,".

(c) DEFINITION OF "SUPERVISED PERSON".—Section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)) is amended—

(1) by striking "requires—" and inserting "requires, the following definitions shall apply:"; and

(2) by adding at the end the following new paragraph:

"(25) 'Supervised person' means any partner, officer, director (or other person occupying a similar status or performing similar functions), or employee of an investment adviser, or other person who provides investment advice on behalf of the investment adviser and is subject to the supervision and control of the investment adviser.".

(d) CONFORMING AMENDMENT.—Section 203(a) of the Investment Advisers Act of 1940 ((15 U.S.C. 80b—3(a)) is amended by striking "subsection (b) of this section" and inserting "subsection (b) and subsection 203A".

SEC. 304 INTERSTATE COOPERATION.

Section 222 of the Investment Advisers Act of 1940 (15 U.S.C. 80b—18a) is amended to read as follows:

"SEC. 222. STATE REGULATION OF INVESTMENT ADVISERS.

"(a) JURISDICTION OF STATE REGULATORS.—Nothing in this title shall affect the jurisdiction of the securities commissioner (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this title or the rules and regulations thereunder.

"(b) DUAL COMPLIANCE PURPOSES.—No State may enforce any law or regulation that would require an investment adviser to maintain any books or records in addition to those required under the laws of the State in which it maintains its principal place of business, if the investment adviser—

"(1) is registered or licensed as such in the State in which it maintains its principal place of business; and

"(2) is in compliance with the applicable books and records requirements of the State in which it maintains its principle place of business.

"(c) LIMITATION ON CAPITAL AND BOND REQUIREMENTS.—No State may enforce any law or regulation that would require an investment adviser to maintain a higher minimum net capital or to post any bond in addition to any that is required under the laws of the State in which it maintains its principal place of business, if the investment adviser—

"(1) is registered or licensed as such in the State in which it maintains its principal place of business; and

"(2) is in compliance with the applicable net capital or bonding requirements of the State in which it maintains its principal place of business.

"(d) NATIONAL DE MINIMIS STANDARD.—No law of any State or political subdivision thereof requiring the registration, licensing, or qualification as an investment adviser shall require an investment adviser to register with the securities commissioner of the State (or any agency or officer performing like functions) or to comply with such law (other than any provision thereof prohibiting fraudulent conduct) if the investment adviser—

"(1) does not have a place of business located within the State; and

"(2) during the preceding 12-month period, has had fewer than 6 clients who are residents of that State.".

SEC. 305. DISQUALIFICATION OF CONVICTED FELONS.

(a) AMENDMENT.—Section 203(e) of the Investment Advisers Act of 1940 (15 U.S.C. 80b—3(e))is amended—

(1) by redesignating paragraphs (3) through (7) as paragraphs (4) through (8) respectively; and

(2) by inserting after paragraph (2) the following new paragraph:

"(3) has been convicted during the 10-year period preceding the date of filing of any application for registration, or at any time thereafter, of—

"(A) any crime that is punishable by imprisonment for 1 or more years, and that is not described in paragraph (2); or

"(B) a substantially equivalent crime by a foreign court of competent jurisdiction.".

(b) CONFORMING AMENDMENTS.—Section 203 of the Investment Advisers Act of 1940 (15 U.S.C. 80b—3) is amended—

(1) in subsection (e)(6) (as redesignated by subsection (a) of this section), by striking "this paragraph (5) and inserting "this paragraph";

(2) in subsection (f) –

(A) by striking "paragraph (1), (4), (5), or (7) of subsection (e) of this section" and inserting "paragraph (1), (5), (6), or (8) of subsection (e);

(B) by striking "paragraph (3)" and inserting "paragraph (4)"; and

(C) by striking "said subsection" each place that term appears and inserting "subsection"; and

(3) in subsection (i)(1)(D), by striking "section 203(e)(5) of this title" and inserting "subsection (e)(6)".

SEC. 306. INVESTOR ACCESS TO INFORMATION.

The Commission shall—

(1) provide for establishment and maintenance of a readily accessible telephonic or other electronic process to receive inquiries regarding disciplinary actions and proceedings involving investment advisers and persons associated with investment advisers; and

(2) provide for prompt response to any inquiry described in paragraph (1).

SEC. 307. CONTINUED STATE AUTHORITY.

(a) PRESERVATION OF FILING REQUIREMENTS.—Nothing in this title or any amendment made by this title prohibits the securities commission (or any agency or office performing like functions) of any State from requiring the filing of any documents filed with the Commission pursuant to the securities laws solely for notice purposes, together with a consent to service of process and any required fee.

(b) PRESERVATION OF FEES.—Until otherwise provided by law, rule, regulation, or order, or other administrative action of any State or any political subdivision thereof, adopted after the date of enactment of this Act, filing, registration, or licensing fees shall, notwithstanding the amendments made by this title, continue to be paid in amounts determined pursuant to the law, rule, regulation, or order, or other administrative action as in effect on the day before such date of enactment.

(c) AVAILABILITY OF PREEMPTION CONTINGENT ON PAYMENT OF FEES.—

(1) IN GENERAL.—During the period beginning on the date of enactment of this Act and ending 3 years after that date of enactment, the securities commission (or any agency or office performing like functions) of any State may require registration of any investment adviser that fails or refuses to pay the fees required by subsection (b) in or to such State, notwithstanding the limitations on the laws, rules, regulations, or orders, or other administrative actions of any State, or any political subdivision thereof, contained in subsection (a), if the laws of such State require registration of investment advisers.

(2) DELAYS.—For purposes of this subsection, delays in payment of fees or underpayments of fees that are promptly remedied in accordance with the applicable laws, rules, regulations, or orders, or other administrative actions of the relevant State shall not constitute a failure or refusal to pay fees.

SEC. 308. EFFECTIVE DATE.

(a) IN GENERAL.—This title and the amendments made by this title shall take effect 180 days after the date of enactment of this Act.

(b) CONFORMING AMENDMENT.—

(1) IN GENERAL.—Section 3(38)(B) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002(38)(B)) is

amended by inserting " or under the laws of any State" after "1940".

(2) SUNSET.—The amendment made by paragraph (1) shall cease to be effective 2 years after the date of enactment of this Act.

TITLE IV—SECURITIES AND EXCHANGE COMMISSION AUTHORIZATION

SEC. 401. SHORT TITLE.

This title may be cited as the "Securities and Exchange Commission Authorization Act of 1996".

SEC. 402. PURPOSES.

The purposes of this title are—

(1) to authorize appropriations for the Commission for fiscal year 1997; and

(2) to reduce over time the rates of fees charged under the Federal securities laws.

SEC. 403. AUTHORIZATION OF APPROPRIATIONS

Section 35 of the Securities Exchange Act of 1934 is amended to read as follows:

*"**SEC. 35. AUTHORIZATION OF APPROPRIATIONS.***

"There are authorized to be appropriated to carry out the functions, powers, and duties of the Commission $300,000,000 for fiscal year 1997, in addition to any other funds authorized to be appropriated to the Commission.".

SEC. 404. REGISTRATION FEES.

Section 6(b) of the Securities Act of 1933 (15 U.S.C. 77f(b)) is amended to read as follows:

"(b) REGISTRATION FEE.—

"(1) RECOVERY OF COST OF SERVICES.—The Commission shall, in accordance with this subsection, collect registration fees that are designed to recover the costs to the government of the securities registration process, and costs related to such process, including enforcement activities, policy, and rulemaking activities, administration, legal services, and international regulatory activities.

"(2) FEE PAYMENT REQUIRED.—At the time of filing a registration statement, the applicant shall pay to the Commission a fee that shall be equal to the sum of the amounts (if any) determined under the rates established by paragraphs (3) and (4). The Commission shall publish in the Federal Register notices of the fee rates applicable under this section for each fiscal year.

"(3) GENERAL REVENUE FEES.—The rate determined under this paragraph is a rate equal to $200 per $1,000,000 of the maximum aggregate price at which such securities are proposed to be offered, except that during fiscal year 2007 and any succeeding fiscal year such rate is equal to $67 per $1,000,000 of the maximum aggregate price at which such securities are proposed to be offered. Fees collected during any fiscal year pursu-

(C) by inserting after clause (v) the following new clause:

"(vi) solely for purposes of sections 12, 13, 14, and 16 of this title, any security issued by or any interest or participation in any church plan, company, or account that is excluded from the definition of an investment company under section 3(c)(14) of the Investment Company Act of 1940; and".

(2) EXEMPTION FROM BROKER-DEALER PROVISIONS.—Section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c) is amended by adding at the end the following new subsection:

"(g) CHURCH PLANS.—No church plan described in section 414(e) of the Internal Revenue Code of 1986, no person or entity eligible to establish and maintain such a plan under the Internal Revenue Code of 1986, no company or account that is excluded from the definition of an investment company under section 3(c)(14) of the Investment Company Act of 1940, and no trustee, director, officer, or employee of or volunteer for such plan, company, account person, or entity, acting within the scope of that person's employment or activities with respect to such plan, shall be deemed to be a 'broker', 'dealer', 'municipal securities broker', 'municipal securities dealer', 'government securities broker', 'government securities dealer', 'clearing agency', or 'transfer agent' for purposes of this title—

"(1) solely because such plan, company, person, or entity buys, holds, sells, trades in, or transfers securities or acts as an intermediary in making payments in connection with transactions in securities for its own account in its capacity as trustee or administrator of, or otherwise on behalf of, or for the account of, any church plan, company, or account that is excluded from the definition of an investment company under section 3(c)(14) of the Investment Company Act of 1940; and

"(2) if no such person or entity receives a commission or other transaction-related sales compensation in connection with any activities conducted in reliance on the exemption provided by this subsection.".

(d) AMENDMENT TO THE INVESTMENT ADVISERS ACT OF 1940.—
Section 203(b) of the Investment Advisers Act of 1940 (15 U.S.C. 80b—3(b)) is amended—

(1) in paragraph (3), by striking "or" at the end;

(2) in paragraph (4), by striking the period at the end and inserting "; or"; and

(3) by adding at the end the following new paragraph:

"(5) any plan described in section 414(e) of the Internal Revenue Code of 1986, any person or entity eligible to establish and maintain such a plan under the Internal Revenue Code of 1986, or any trustee, director, officer, or employee of or volunteer for any such plan or person, if such person or entity, acting in such capacity, provides investment advice exclusively to, or with respect to, any plan, person, or entity or any company, account, or fund that is excluded from the definition of an investment company under section 3(c)(14) of the Investment Company Act of 1940.".

(e) AMENDMENT TO THE TRUST INDENTURE ACT OF 1939.—Section 304(a)(4)(A) of the Trust Indenture Act of 1939 (15 U.S.C.

The Managers agreed to include certain amendments to the Investment Advisers Act of 1940 to eliminate duplication, promote efficiency, and protect investors.

TOM BLILEY,
JACK FIELDS,
MICHAEL G. OXLEY,
BILLY TAUZIN,
DAN SCHAEFER,
NATHAN DEAL,
DAN FRISA,
RICK WHITE,
JOHN D. DINGELL,
EDWARD J. MARKEY,
BART GORDON,
ELIZABETH FURSE,
RON KLINK
Managers on the Part of the House.

ALFONSE D'AMATO,
PHIL GRAMM,
ROBERT F. BENNETT,
PAUL S. SARBANES,
CHRIS DODD,
Managers on the Part of the Senate.

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