104TH CONGRESS
1st Session

HOUSE OF REPRESENTATIVES

REPORT
104–333

PHILANTHROPY PROTECTION ACT OF 1995

NOVEMBER 10, 1995.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. BLILEY, from the Committee on Commerce, submitted the following

REPORT

[To accompany H.R. 2519]

[Including cost estimate of the Congressional Budget Office]

The Committee on Commerce, to whom was referred the bill (H.R. 2519) to facilitate contributions to charitable organizations by codifying certain exemptions from the Federal securities laws, and for other purposes, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

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The amendment is as follows:

Strike out all after the enacting clause and insert in lieu thereof the following:

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the "Philanthropy Protection Act of 1995".

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

29–006

Sec. 1. Short title; table of contents.
Sec. 2. Amendments to the Investment Company Act of 1940.
Sec. 3. Amendment to the Securities Act of 1933.
Sec. 4. Amendments to the Securities Exchange Act of 1934.
Sec. 5. Amendment of the Investment Advisers Act of 1940.
Sec. 6. Protection of philanthropy under state law.
Sec. 7. Effective dates and applicability.

SEC. 2. AMENDMENTS TO THE INVESTMENT COMPANY ACT OF 1940.

(a) EXEMPTION.—Section 3(c)(10) of the Investment Company Act of 1940 (15 U.S.C. 80a–3(c)(10)) is amended to read as follows:

"(10)(A) Any company organized and operated exclusively for religious, educational, benevolent, fraternal, charitable, or reformatory purposes—

"(i) no part of the net earnings of which inures to the benefit of any private shareholder or individual; or

"(ii) which is or maintains a fund described in subparagraph (B).

"(B) For the purposes of subparagraph (A)(ii), a fund is described in this subparagraph if such fund is a pooled income fund, collective trust fund, collective investment fund, or similar fund maintained by a charitable organization exclusively for the collective investment and reinvestment of one or more of the following:

"(i) assets of the general endowment fund or other funds of one or more charitable organizations;

"(ii) assets of a pooled income fund;

"(iii) assets contributed to a charitable organization in exchange for the issuance of charitable gift annuities;

"(iv) assets of a charitable remainder trust or of any other trust, the remainder interests of which are irrevocably dedicated to any charitable organization;

"(v) assets of a charitable lead trust;

"(vi) assets of a trust not described in clauses (i) through (v), the remainder interests of which are revocably dedicated to a charitable organization, subject to subparagraph (C); or

"(vii) such assets (including assets revocably dedicated to a charitable organization) as the Commission may prescribe by rule, regulation, or order in accordance with section 6(c).

"(C) A fund that contains assets described in clause (vi) of subparagraph (B) shall be excluded from the definition of an investment company for a period of 3 years after the date of enactment of this subparagraph, but only if—

"(i) such assets were contributed before the date which is 60 days after the date of enactment of this subparagraph; and

"(ii) such assets are commingled in the fund with assets described in one or more of clauses (i) through (v) of subparagraph (B).

"(D) For purposes of this paragraph—

"(i) a trust or fund is 'maintained' by a charitable organization if the organization serves as a trustee or administrator of the trust or fund or has the power to remove the trustees or administrators of the trust or fund and to designate new trustees or administrators;

"(ii) the term 'pooled income fund' has the same meaning as in section 642(c)(5) of the Internal Revenue Code of 1986;

"(iii) the term 'charitable organization' means an organization described in paragraphs (1) through (5) of section 170(c) or section 501(c)(3) of the Internal Revenue Code of 1986;

"(iv) the term 'charitable lead trust' means a trust described in section 170(f)(2)(B), 2055(e)(2)(B), or 2522(c)(2)(B) of the Internal Revenue Code of 1986;

"(v) the term 'charitable remainder trust' means a charitable remainder annuity trust or a charitable remainder unitrust, as those terms are defined in section 664(d) of the Internal Revenue Code of 1986; and

"(vi) the term 'charitable gift annuity' means an annuity issued by a charitable organization that is described in section 501(m)(5) of the Internal Revenue Code of 1986.".

(b) DISCLOSURE BY EXEMPT CHARITABLE ORGANIZATIONS.—Section 7 of the Investment Company Act of 1940 (15 U.S.C. 80a–7) is amended by adding at the end the following new subsection:

"(e) DISCLOSURE BY EXEMPT CHARITABLE ORGANIZATIONS.—Each fund that is excluded from the definition of an investment company under section 3(c)(10)(B) of this Act shall provide, to each donor to such fund, at the time of the donation or within 90 days after the date of enactment of this subsection, whichever is later, written information describing the material terms of the operation of such fund.".

SEC. 3. AMENDMENT TO THE SECURITIES ACT OF 1933.

Section 3(a)(4) of the Securities Act of 1933 (15 U.S.C. 77c(a)(4)) is amended by inserting after the semicolon at the end the following: "or any security of a fund that is excluded from the definition of an investment company under section 3(c)(10)(B) of the Investment Company Act of 1940;".

SEC. 4. AMENDMENTS TO THE SECURITIES EXCHANGE ACT OF 1934.

(a) EXEMPTED SECURITIES.—Section 3(a)(12)(A) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(12)(A)) is amended—

(1) in clause (iv) by striking "and" at the end;

(2) by redesignating clause (v) as clause (vi); and

(3) by inserting after clause (iv) the following new clause:

"(v) any security issued by or any interest or participation in any pooled income fund, collective trust fund, collective investment fund, or similar fund that is excluded from the definition of an investment company under section 3(c)(10)(B) of the Investment Company Act of 1940; and".

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

"(e) CHARITABLE ORGANIZATIONS.—

"(1) EXEMPTION.—Notwithstanding any other provision of this title, but subject to paragraph (2) of this subsection, a charitable organization, as defined in section 3(c)(10)(D) of the Investment Company Act of 1940, or any trustee, director, officer, employee, or volunteer of such a charitable organization acting within the scope of such person's employment or duties with such organization, shall not be deemed to be a 'broker', 'dealer', 'municipal securities broker', 'municipal securities dealer', 'government securities broker', or 'government securities dealer' for purposes of this title solely because such organization or person buys, holds, sells, or trades in securities for its own account in its capacity as trustee or administrator of, or otherwise on behalf of or for the account of—

"(A) such a charitable organization;

"(B) a fund that is excluded from the definition of an investment company under section 3(c)(10)(B) of the Investment Company Act of 1940; or

"(C) a trust or other donative instrument described in section 3(c)(10)(B) of the Investment Company Act of 1940, or the settlors (or potential settlors) or beneficiaries of any such trust or other instrument.

"(2) LIMITATION ON COMPENSATION.—The exemption provided under paragraph (1) shall not be available to any charitable organization, or any trustee, director, officer, employee, or volunteer of such a charitable organization, unless each person who, on or after 90 days after the date of enactment of this subsection, solicits donations on behalf of such charitable organization from any donor to a fund that is excluded from the definition of an investment company under section 3(c)(10)(B) of the Investment Company Act of 1940, is either a volunteer or is engaged in the overall fund raising activities of a charitable organization and receives no commission or other special compensation based on the number or the value of donations collected for the fund.".

(d) CONFORMING AMENDMENT.—Section 12(g)(2)(D) of such Act (15 U.S.C. 78l(g)(2)(D)) is amended by inserting before the period "; or any security of a fund that is excluded from the definition of an investment company under section 3(c)(10)(B) of the Investment Company Act of 1940".

SEC. 5. AMENDMENT OF THE INVESTMENT ADVISERS ACT OF 1940.

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

(1) by striking "or" at the end of paragraph (2);

(2) by striking the period at the end of paragraph (3) and inserting "; or"; and

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

"(4) any investment adviser that is a charitable organization, as defined in section 3(c)(10)(D) of the Investment Company Act of 1940, or is a trustee, director, officer, employee, or volunteer of such a charitable organization acting within the scope of such person's employment or duties with such organization, whose advice, analyses, or reports are provided only to one or more of the following:

"(A) any such charitable organization;

"(B) a fund that is excluded from the definition of an investment company under section 3(c)(10)(B) of the Investment Company Act of 1940; or

"(C) a trust or other donative instrument described in section 3(c)(10)(B) of the Investment Company Act of 1940, or the trustees, administrators, settlors (or potential settlors), or beneficiaries of any such trust or other instrument.".

SEC. 6. PROTECTION OF PHILANTHROPY UNDER STATE LAW.

(a) REGISTRATION REQUIREMENTS.—A security issued by or any interest or participation in any pooled income fund, collective trust fund, collective investment fund, or similar fund that is excluded from the definition of an investment company under section 3(c)(10)(B) of the Investment Company Act of 1940, and the offer or sale thereof, shall be exempt from any statute or regulation of a State that requires registration or qualification of securities.

(b) TREATMENT OF CHARITABLE ORGANIZATIONS.—No charitable organization, or any trustee, director, officer, employee, or volunteer of a charitable organization acting within the scope of such person's employment or duties, shall be required to register as, or be subject to regulation as, a dealer, broker, agent, or investment adviser under the securities laws of any State because such organization or person buys, holds, sells, or trades in securities for its own account in its capacity as trustee or administrator of, or otherwise on behalf of or for the account of one or more of the following:

(1) a charitable organization;

(2) a fund that is excluded from the definition of an investment company under section 3(c)(10)(B) of the Investment Company Act of 1940; or

(3) a trust or other donative instrument described in section 3(c)(10)(B) of the Investment Company Act of 1940, or the settlors (or potential settlors) or beneficiaries of any such trusts or other instruments.

(c) STATE ACTION.—Notwithstanding subsections (a) and (b), during the 3-year period beginning on the date of enactment of this Act, a State may enact a statute that specifically refers to this section and provides prospectively that this section shall not preempt the laws of that State referred to in this section.

(d) DEFINITIONS.—For purposes of this section—

(1) the term "charitable organization" means an organization described in paragraphs (1) through (5) of section 170(c) or section 501(c)(3) of the Internal Revenue Code of 1986;

(2) the term "security" has the same meaning as in section 3 of the Securities Exchange Act of 1934; and

(3) the term "State" means each of the several States of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, Guam, American Samoa, and the Commonwealth of the Northern Mariana Islands.

SEC. 7. EFFECTIVE DATES AND APPLICABILITY.

This Act and the amendments made by this Act shall apply in all administrative and judicial actions pending on or commenced after the date of enactment of this Act, as a defense to any claim that any person, security, interest, or participation of the type described in this Act and the amendments made by this Act are subject to the provisions of the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, or the Investment Advisers Act of 1940, or any State statute or regulation preempted as provided in section 6 of this Act, except as otherwise specifically provided in such Acts or State law.

PURPOSE AND SUMMARY

The purpose of H.R. 2519, the "Philanthropy Protection Act of 1995," is to protect and facilitate donations to entities organized and operated exclusively for religious, educational, benevolent, fraternal, charitable, or reformatory purposes (collectively referred to as "charitable organizations") by limiting the applicability of Federal and State securities laws to the activities of such organizations in connection with the maintenance of certain pooled funds (collectively referred to as "charitable income funds"). Charitable income funds include a variety of vehicles that permit donors to make contributions and retain a remainder interest, usually a lifetime income interest, in the donated property. Such funds are currently the subject of litigation in at least one Federal court [1] based on the allegation that the funds are investment companies that are subject to the registration and other requirements of the Investment

[1] Civil Action N. 7–94CV–128–X (N.D. Tex.).

Company Act of 1940. If such funds are found to be investment companies subject to these requirements, contributions to every charitable organization in the country could be revoked based on similar claims.

The legislation provides certain exemptions under the Federal securities laws for charitable organizations that maintain charitable income funds. The legislation also preempts, for at least three years, certain State securities laws relating to companies that are or maintain charitable income funds.

Background and Need for Legislation

I. Description of Charitable Income Funds Vis-a-Vis Federal Securities Laws

A charitable income fund is a fund maintained by a charitable organization, to which a person transfers property but retains an interest in the property. Usually the donor transfers a remainder interest in the property and retains a lifetime income interest, although not necessarily; for example, a donor to a charitable lead trust transfers the income interest of a corpus to a charitable organization, while the remainder interest in the corpus passes to the donor's designated beneficiaries.

The charitable income fund includes commingled assets received from multiple transfers to the charitable organization. Each income beneficiary of the fund receives a proportionate share of the income earned by the fund each year. When a beneficiary's income interest terminates (by the terms of the instrument by which it was created, generally on the death of the income beneficiary), the remainder interest in the property upon which the income interest was based is paid to (or retained by) the charitable organization.

As discussed below, the status under Federal securities laws of charitable income funds, the income interests in those funds, the charitable organizations maintaining the funds, and the persons who solicit donations to the funds is unclear, as illustrated by an examination of certain definitions under those laws.

A. Definitions

Investment Company.—Section 3(a)(1) of the Investment Company Act of 1940, 15 U.S.C. 80a–3(a)(1) (the "Investment Company Act"), defines "investment company" to mean any issuer which is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities.

Issuer.—Section 2(a)(22) of the Investment Company Act, 15 U.S.C. 80a–2(a)(22), section 2(4) of the Securities Act of 1933, 15 U.S.C. 77b–2(4) (the "Securities Act"), and section 3(a)(8) of the Securities Exchange Act of 1934, 15 U.S.C. 78c–3(a)(8) (the "Exchange Act"), each define "issuer" to mean every person who issues or proposes to issue any security (the Investment Company Act also includes in this definition every person who has outstanding any security which it has issued).

Security.—Section 2(a)(36) of the Investment Company Act, 15 U.S.C. 80b–2(a)(36), section 2(1) of the Securities Act, 15 U.S.C. 77b–2(1), and section 3(a)(10) of the Exchange Act, 15 U.S.C. 78c–

3(a)(10), each define "security" to mean, among other things, any investment contract. The test for an investment contract is "whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." *Securities and Exchange Commission* v. *W.J. Howey Co.,* 328 U.S. 293, 301 (1946). The Court noted that it was "immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise." 328 U.S. at 299.

Broker.—Section 3(a)(4) of the Exchange Act, 15 U.S.C. 78c–3(a)(4), defines "broker" to mean "any person engaged in the business of effecting transactions in securities for the account of others * * *."

Investment Adviser.—Section 202(a)(11) of the Investment Advisers Act, 15 U.S.C. 80b–2(a)(11) (the "Advisers Act"), defines "investment adviser" to mean, among other things, "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities."

Under these statutory provisions, because the money of donors to charitable income funds is pooled together in a "common enterprise" (the charitable income fund) with "profits" (the retained interest in the gift, usually a lifetime income interest) to come solely from the efforts of others (those who maintain the charitable income fund), the acquisition of an interest in a charitable income fund for consideration may be an investment contract. In that case, the interest would be a security of which the charitable income fund would be the issuer. If the charitable income fund were an issuer of a security, it would, if primarily engaged in the business of investing in securities, be an investment company. A person who is engaged in the business of soliciting donations to the charitable income fund would thus be engaged in the business of "effecting transactions" in "securities," and would therefore be a broker. Finally, a person who is engaged in the business of advising a charitable income fund as to the investment of its assets may be viewed as an investment adviser.

B. Charitable Organization Exemptions Under the Securities Laws

Section 3(c)(10) of the Investment Company Act, 15 U.S.C. 80b–3(c)(10), excludes from the definition of investment company any company organized and operated exclusively for religious, educational, benevolent, fraternal, charitable, or reformatory purposes, provided that no part of the company's net earnings inures to the benefit of any person, private shareholder or individual. Similarly, section 3(a)(4) of the Securities Act, 15 U.S.C. 77c–3(a)(4), and section 12(g)(2)(D) of the Exchange Act, 15 U.S.C. 78l–12(g)(2)(D), exempt from their provisions (other than their anti-fraud provisions) any security issued by a person organized and operated exclusively for religious, educational, benevolent, fraternal, charitable, or reformatory purposes and not for pecuniary profit, provided that no part of the company's net earnings inures to the benefit of any person, private shareholder or individual.

Because the nature (indeed, the very purpose) of charitable income funds is to provide a financial interest to donors in the funds' net earnings, part of the funds' net earnings may be viewed as inuring to the benefit of persons and individuals. Therefore, the applicability of the charitable organization exemptions under the Investment Company Act, Securities Act, and Exchange Act is subject to question.

The staff of the Securities and Exchange Commission (the "Commission") has addressed the questions raised by charitable income funds under the Investment Company Act, Securities Act, and Exchange Act on a number of occasions over the past twenty-three years. In particular, the staff has provided no-action assurance under certain circumstances when charitable income funds have operated: without being registered under the Investment Company Act, without registering interests in the funds under the Securities Act or the Exchange Act; and without registering themselves, or persons soliciting gifts on their behalf, as broker-dealers under the Exchange Act.[2] The circumstances under which registration has not been required are: (1) the charitable income fund holds no assets contributed through a revocable donation;[3] (2) the fund qualifies as a recipient of tax-deductible contributions under the Internal Revenue Code of 1986; (3) each prospective donor receives written disclosures fully and fairly describing the fund's operations; and (4) any person soliciting contributions to the fund is either a volunteer or is employed in the charity's overall fundraising activities and is not compensated on the basis of the amount of gifts transferred to the fund.[4]

Notwithstanding the staff's view that certain charitable income funds can operate without registering under the Federal securities laws, the staff consistently has taken the position that the antifraud provisions of the Federal securities laws apply to the activities of those funds and their associated persons.[5]

The rationale for the staff's position with respect to charitable income funds is that the primary purpose of persons who transfer property to these funds is to make a charitable donation, not to make an investment. The staff has concluded that this donative intent—combined with, among other things, the protections afforded by disclosure to donors and the applicability of the anti- fraud provisions of the securities laws to the operations of charitable income funds—makes registration under the Federal securities laws unnecessary.

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[2] See, e.g., Investment Company Act Release No. 11016 (Jan. 10, 1980); National Foundation for Philanthropy (pub. avail. Mar. 21, 1985); Princeton University (pub. avail. Aug. 26, 1982).

[3] See Society for the Propagation of the Faith (pub. avail. Aug. 23, 1984) (where charitable organization pooled together assets donated by irrevocable and revocable trusts, the pool would have to register as an investment company; staff was unconvinced that the donors of the revocable trusts "evidence a true charitable donative intent and not the intention of an investor.").

[4] The Commission historically has viewed the receipt of transaction-based compensation as potentially providing the incentive to persons who work for charitable organizations to engage in high-pressure or abusive sales practices. See Securities Exchange Act Release No. 22172 (June 27, 1985) (adopting Exchange Act rule 3a4–1). Accordingly, the staff has conditioned its position that associated persons of charitable organizations are exempt from the broker-dealer provisions of the Exchange Act upon the absence of this type of compensation. See authorities cited above in note 2.

[5] E.g., Investment Company Act Release No. 11016 (Jan. 10, 1980); American Council on Education (pub. avail. Dec. 15, 1972).

II. NEED FOR AND SCOPE OF LEGISLATION

A favorable letter from the Commission's staff regarding a particular transaction, however, does not insulate the recipient, or others similarly situated, from liability to a private litigant who alleges that the same transaction violates the Federal securities laws.

In addition, every State imposes securities laws separate from the Federal securities laws. In general, State securities laws (also known as "blue sky laws") require registration of securities and may also require qualification of securities. State securities laws also impose registration and other regulatory requirements on dealers, brokers, agents, and investment advisers. Accordingly, as in the case of the Federal securities laws noted above, the applicability of State securities laws to charitable income funds and persons associated with them is uncertain.

A plaintiff recently filed a class action in Federal district court in Texas alleging, among other things, that charitable income funds are investment companies required to register under the Investment Company Act.[6] This lawsuit has created uncertainty among charitable organizations nationwide as to the applicability of the Federal securities laws to charitable income funds.[7] Among other things, a charitable income fund that is an unregistered investment company could have all of its transactions invalidated, and might be required to return all donations.[8]

The legislation is intended to eliminate the uncertainty created by the Texas litigation by codifying the approach taken by the Commission's staff to permit charitable income funds to operate without registration under the Investment Company Act, Securities Act, and Exchange Act, and by providing further exemptions from Federal and State securities laws to charitable organizations and persons associated with them in connection with the maintenance and operation of charitable income funds. To ensure that the remedies provided by the legislation are available to the charitable organizations that spurred the need for the legislation, the legislation applies to actions pending on the date of the legislation's effectiveness.

Consistent with the conditions of the relief accorded by the Commission staff to charitable income funds, the legislation includes safeguards regarding disclosure to donors, asset-based solicitation compensation, and fraud. Because the legislation does not affect the reach or scope of the anti-fraud provisions of the Federal or State securities laws, such anti-fraud laws will continue to prohibit

[6] Civil Action N. 7–94CV–128–X (N.D. Tex.).

[7] A favorable ruling for the plaintiff on the plaintiff's Federal securities law complaints would create a precedent that could render every charitable organization in the nation that operates a charitable donation pool vulnerable to similar lawsuits. See Cong. Rec. E2006 (daily ed. Oct. 24, 1995) (remarks of Rep. Fields) ("Some organizations have already stopped accepting gifts through their charitable donation pools for fear a class action will send that money right back out the door—into the pockets of plaintiffs and their lawyers.").

[8] Contracts entered into by unregistered investment companies may fall under section 47(b) of the Investment Company Act, 15 U.S.C. 80a–46(b), which provides that a contract made or performed in violation of the Act is unenforceable by either party unless a court finds that, in a particular case, enforcement would produce a more equitable result and would not be inconsistent with the purposes of the Act. The plaintiff in the Texas lawsuit, among other things, seeks rescission under section 47(b) of certain charitable donations made to certain of the defendants.

"Ponzi" schemes and other frauds perpetrated under the guise of charitable activity.

HEARINGS

On October 31, 1995, the Subcommittee on Telecommunications and Finance held a legislative hearing on H.R. 2519. Witnesses included: Mr. Barry P. Barbash, Director, Division of Investment Management, U.S. Securities and Exchange Commission; Mr. Terry L. Simmons, President, Charitable Accord, and Vice President and General Counsel, Baptist Foundation of Texas; Mr. Paul Fritz Kling, Director of Planned Gifts, University of Richmond; Ms. Katelyn Quynn, Director of Planned Giving, Massachusetts General Hospital; and Mr. Douglas E. White, Director of Client Relations, Kaspick & Co.

COMMITTEE CONSIDERATION

On October 31, 1995, the Subcommittee on Telecommunications and Finance met in open markup session and approved H.R. 2519 for Full Committee consideration, without amendment, by a voice vote, a quorum being present. On November 1, 1995, the Full Committee met in open markup session an ordered H.R. 2519, as amended, reported to the House, by a voice vote, a quorum being present.

ROLLCALL VOTES

Clause 2(l)(2)(B) of rule XI of the Rules of the House requires the Committee to list the recorded votes on the motion to report legislation and on amendments thereto. There were no recorded votes taken in connection with ordering H.R. 2519 reported or in adopting the amendment. The voice votes taken in Committee are as follows:

COMMITTEE ON COMMERCE—104TH CONGRESS

Bill: H.R. 2519, Philanthropy Protection Act of 1995.
Amendment: Amendment in the Nature of a Substitute by Mr. Fields.
Disposition: Agreed to, by a voice vote.
Motion: Motion by Mr. Fields to order H.R. 2519, as amended, reported to the House.
Disposition: Agreed to, by a voice vote.

COMMITTEE OVERSIGHT FINDINGS

Pursuant to clause 2(l)(3)(A) of rule XI of the Rules of the House of Representatives, the Subcommittee on Telecommunications and Finance held a legislative hearing and made findings that are reflected in this report.

COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT

Pursuant to clause 2(l)(3)(D) of rule XI of the Rules of the House of Representatives, no oversight findings have been submitted to the Committee by the Committee on Government Reform and Oversight.

NEW BUDGET AUTHORITY AND TAX EXPENDITURES

In compliance with clause 2(l)(3)(b) of rule XI of the Rules of the House of Representatives, the Committee states that H.R. 2519 would result in no new or increased budget authority or tax expenditures or revenues.

COMMITTEE COST ESTIMATE

In compliance with clause 7(a) of rule XIII of the Rules of the House of Representatives, the Committee adopts as its own the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 403 of the Congressional Budget Act of 1974.

CONGRESSIONAL BUDGET OFFICE ESTIMATE

Pursuant to clause 2(l)(3)(C) of rule XI of the Rules of the House of Representatives, following is the cost estimate provided by the Congressional Budget Office pursuant to section 403 of the Congressional Budget Act of 1974:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, November 8, 1995.

Hon. THOMAS J. BLILEY, Jr.,
Chairman, Committee on Commerce,
House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has reviewed H.R. 2519, the Philanthropy Protection Act of 1995, as ordered reported by the House Committee on Commerce on November 1, 1995. CBO estimates that enacting H.R. 2519 would not result in any significant cost to the Federal Government. Because enactment of H.R. 2519 would not affect direct spending or receipts, pay-as-you-go procedures would not apply to the bill.

H.R. 2519 would amend the federal securities laws to exempt certain types of charitable income funds from the registration laws and fees which apply to investment companies. A charitable income fund allows donors to make contributions to charities while retaining remainder interest in the donation, usually in the form of a lifetime income stream from the asset. Charities often commingle the assets to form different types of charitable income funds in order to manage the assets more efficiently.

Current law exempts a charity from the registration laws and fees as long as no part of the charity's net earnings accrue to any private shareholder or individual. The Securities and Exchange Commission (SEC) interprets the law to include charitable income funds; thus such funds are exempt from the registration laws and fees. This bill would codify the current practice of the SEC with regards to charitable income funds and would have no effect on the amount of registration fees paid to the federal government. The bill would retain the anti-fraud and disclosure requirements that currently apply to both investment companies and charitable organizations and trusts.

H.R. 2519 would preempt existing state laws regarding the exclusion of charities and charitable trusts from registration laws for a

period of three years following the enactment of the bill. CBO estimates that the bill would not affect the budgets of state or local governments.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Rachel Forward.

Sincerely,

JAMES L. BLUM
(For June E. O'Neill, Director).

INFLATIONARY IMPACT STATEMENT

Pursuant to clause 2(l)(4) of rule XI of the Rules of the House of Representatives, the Committee finds that the bill would have no inflationary impact.

ADVISORY COMMITTEE STATEMENT

No advisory committees within the meaning of section 5(b) of the Federal Advisory Committee Act were created by this legislation.

SECTION-BY-SECTION ANALYSIS OF THE LEGISLATION

Sec. 1. Short title.

This section provides that the Act may be cited as the "Philanthropy Protection Act of 1995." It also provides a table of contents of the Act.

Sec. 2. Amendment to the Investment Company Act of 1940.

Exclusion from definition of investment company.—Section 2(a) of the legislation amends section 3(c)(10) of the Investment Company Act to exclude from the definition of "investment company" any collective investment fund maintained by a charitable organization exclusively for the collective investment and reinvestment of certain defined assets.

These assets, defined more specifically below, include property contributed by donors who retain an interest, usually a lifetime income interest, in the donated property, or who contribute property in exchange for an annuity. The collective investment funds that are excluded from the definition of investment company under this section are referred to hereafter as "charitable income funds."

Section 2(a) of the legislation adds paragraph (B) to section 3(c)(10). Paragraph (B) states that a charitable income fund must be maintained exclusively for the collective investment of: (i) the assets of the general endowment fund or other funds of one or more charitable organizations; (ii) the assets of a pooled income fund, as that term is defined in the Internal Revenue Code of 1986 (the "Code"); (iii) assets contributed to a charitable organization in exchange for the issuance of charitable gift annuities, as described in the Code; (iv) the assets of a charitable remainder trust (as defined in the Code) or any other trust whose remainder interests are irrevocably dedicated to a charitable organization; and (v) the assets of a charitable lead trust, as described in the Code.

Clauses (vi) and (vii) of paragraph (B) provide conditional or limited exemptive relief to charitable income funds that include assets that are revocably donated or that are not otherwise exempt under

clauses (i) through (v) of paragraph (B) of amended section 3(c)(10), as described below.

The Commission staff has not accorded the same relief from the Federal securities laws to charitable income funds that contain assets that are revocably donated as it has to funds containing only irrevocably donated assets.[9] The staff has denied this relief based on the concern that donors of revocable gifts may not have a "true charitable intent" as opposed to the "intention of an investor".[10] Nevertheless, section 2(a) of the legislation adds clauses (vi) and (vii) to amended section 3(c)(10) in order to prevent the undesirable result of exposing charitable organizations that maintain charitable income funds that contain revocably donated (and other) assets to the litigation risk that the Texas suit has created for all charitable income funds.

Clause (vi) is a grandfather clause that, together with the conditions imposed by paragraph (C) of amended section 3(c)(10), permits a charitable income fund, for a period of three years following the legislation's enactment, to continue to hold (but not to receive, after a grace period of 60 days) assets donated by a trust, the remainder interests of which are revocably dedicated to the charitable organization. This provision is intended to permit charitable income funds that currently include revocable assets to be restructured to qualify for the permanent exemptive provisions of the legislation.

Clause (vii) explicitly ratifies the Commission's authority to expand the scope of the permanent exemptive provisions of the legislation to include: (1) funds that may include assets not defined in sections (i) through (vi) of new section 3(c)(10)(B); and (2) funds that may include assets that are revocably donated. This provision is not intended to limit in any way the broad exemptive authority of the Commission under section 6(c) of the Investment Company Act, 15 U.S.C. 80a–6(c).

One purpose of this exemptive provision is to ensure that developments in planned giving, such as the creation of a new type of instrument that is not in use today or the use of an instrument that is otherwise not described in sections (i) through (vi) of new section 3(c)(10)(B), do not cause charitable organizations using such instruments to be subject to the uncertainty under the Federal securities laws that the legislation is designed to eliminate.

Another purpose of the provision is to ensure that the Commission retains the flexibility to exempt from the Investment Company Act, under certain circumstances, a fund that includes revocably donated assets but does not meet the requirements of the grandfather clause.[11] Such flexibility might be warranted where, for example, donations to a charitable income fund are revocable in the event of health emergencies or other extenuating circumstances, or where revocable donations comprise a very small proportion of a charitable income fund. In these and other circumstances, the concern that the donors of revocable trusts may not evidence true charitable intent[12] may not be substantiated by the facts at hand,

[9] See supra n.3.
[10] Id.
[11] That is, new clause 3(c)(10)(B)(vi) of the Investment Company Act.
[12] E.g., Society For the Propagation of the Faith, supra n.3.

or may not justify the consequences of the denial of the legislation's exemptive provisions to a charitable income fund.

Definitions.—Section 2(a) also adds subparagraph (D) to section 3(c)(10) to provide definitions of the terms used in the new provisions added to the Investment Company Act. These definitions cross-reference appropriate sections of the Code with respect to the various charitable instruments and organizations referred to in the legislation.

Disclosure requirement.—Section 2(b) of the legislation amends section 7 of the Investment Company Act to add paragraph (e), which requires that each fund that is excluded from the definition of an investment company under amended section 3(c)(10)(B) of the Act shall provide, to each donor of the fund, at the later of the time of donation or within 90 days after the date of enactment of the legislation, written information describing the material terms of the operation of the fund.

This disclosure requirement is not a condition upon which the exemption from the Investment Company Act is based. Accordingly, a charitable income fund that fails to provide the requisite written information will not become subject to the provisions of the Investment Company Act (and, therefore, the other securities laws amended by the legislation), although the fund may be subject to enforcement or other action by the Commission in connection with such a statutory violation. The disclosure requirement is intended to afford charitable organizations flexibility in determining the contents of the required disclosure.

Sec. 3. Amendment to the Securities Act of 1933

Section 3 of the legislation amends section 3(a)(4) of the Securities Act. Section 3(a) of the Securities Act exempts certain classes of securities from the provisions of that Act (except as otherwise provided, as in, for example, the Act's anti-fraud provisions). Paragraph (4) of that section exempts securities issued by the same entities currently listed in section 3(c)(10) of the Investment Company Act.

Section 3 of the legislation extends the exemption in paragraph (4) of Securities Act section 3(a) to interests in any charitable income fund that is excluded from the definition of investment company under section 3(c)(10) of the Investment Company Act, as amended by section 2 of the legislation. As noted in the parenthetical above, this provision does not exempt charitable income funds from the anti-fraud provisions of the Securities Act.

Sec. 4. Amendments to the Securities Exchange Act of 1934

Exempted securities.—Section 4(a) amends the definition of exempted securities under section 3(a)(12)(A) of the Exchange Act to include any security issued by a charitable income fund that is excluded from the definition of investment company under section 3(c)(10) of the Investment Company Act, as amended by section 2 of the legislation. This amendment, like the amendments to the Securities Act noted above, does not exempt charitable income funds from the anti-fraud provisions of the Exchange Act.

Broker-dealer regulations.—Section 4(b) adds a new subsection (e) to section 3 of the Exchange Act. This new subsection provides

in paragraph (1) that, subject to the conditions of paragraph (2), a charitable organization, or any trustee, director, officer, employee, or volunteer of a charitable organization, acting within the scope of his or her employment or duties with such organization, will not be subject to the broker-dealer regulations of the Exchange Act solely because such organization or person trades in securities on behalf of a charitable organization, a charitable income fund, or the settlors, potential settlors or beneficiaries thereof.

The exemption from the Exchange Act broker-dealer provisions is subject to the condition, set forth in paragraph (2) of subsection (e), that any person soliciting donations on behalf of such a charitable organization must be either a volunteer or employed in the overall fund-raising activities of a charitable organization, and that such a person must not receive any special compensation based on the number or value of donations collected for the fund. This condition applies after a 90-day grace period following enactment of the legislation.

The exemption from the Exchange Act's broker-dealer provisions is conditional because, while charitable organizations should remain free to compensate persons who solicit donations based on their success in obtaining donations, persons who are so compensated may be acting as brokers, and, accordingly, should not necessarily be statutorily exempt from the broker-dealer provisions of the Exchange Act.

Registration requirements.—Section 4(d) of the legislation amends section 12(g)(2)(D) of the Exchange Act to exempt from the registration provisions of Exchange Act section 12(g)(1) any security issued by a charitable income fund that is excluded from the definition of investment company under section 3(c)(10) of the Investment Company Act, as amended by section 2 of the legislation.

Sec. 5. Amendment to the Investment Advisers Act of 1940

Section 5 of the legislation adds a new paragraph (4) to section 203(b) of the Advisers Act to add a new category of investment advisers that is exempt from registration. Generally, the Investment Advisers Act requires investment advisers—defined to include persons who provide advice, analyses, or reports concerning securities—to register, unless they are exempted from registration under section 203(b) of the Advisers Act. New paragraph (4) exempts from registration certain persons associated with a charitable organization (and the organization itself) if such persons, acting within the scope of their duties with the organization, provide advice, analyses, or reports solely to one or more of the following: a charitable organization; a charitable income fund that is excluded from the definition of investment company under section 3(c)(10) of the Investment Company Act, as amended by section 2 of the legislation; or a trust or other donative instrument described in section 3(c)(10)(B) of the Investment Company Act, as amended by the legislation, or the trustees, administrators, settlors (or potential settlors), or beneficiaries of any such trust or other instrument. Although such persons are exempt from registration as investment advisers, they remain subject to the anti-fraud provision of the Advisers Act.

Sec. 6. Protection of philanthropy under State law

Preemption.—Subject to section 6(c), section 6(a) of the legislation provides that interests in charitable income funds excluded from the definition of investment company under amended section 3(c)(10) of the Investment Company Act and the offer or sale of such interests shall be exempt from any State law that requires registration or qualification of securities. Section 6(b) of the legislation provides that no charitable organization or trustee, director, officer, employee, or volunteer of a charitable organization acting within the scope of his or her employment or duties shall be subject to regulation as a dealer, broker, agent or investment adviser under any State securities law because such organization or person trades in securities on behalf of a charitable organization, a charitable income fund, or the settlors, potential settlors or beneficiaries thereof. Section 6 of the legislation is not intended to alter the reach or scope of State anti-fraud laws.

Opt-out provision.—Section 6(c) of the legislation permits any State to enact a statute that specifically refers to section 6 of the legislation and provides prospectively that such section shall not preempt the laws of that State. The State may enact such a statute at any time during the three-year period beginning on the date of the legislation's enactment.

The purpose of section 6 is to ensure that the exemptions provided under Federal law by the legislation are not immediately vitiated by State securities laws.

Sec. 7. Effective dates and applicability

Section 7 provides that the amendments effected by the legislation shall apply in all administrative and judicial actions pending on or commenced after the date of enactment. This provision is intended to render moot the securities law claims in the Texas case referred to above [13] as well as in any other action pending on the date of the legislation's effectiveness.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3 of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

INVESTMENT COMPANY ACT OF 1940

* * * * * * *

TITLE I—INVESTMENT COMPANIES

* * * * * * *

DEFINITION OF INVESTMENT COMPANY

SEC. 3. (a) * * *

* * * * * * *

[13] See supra n.6.

(c) Notwithstanding subsection (a), none of the following persons is an investment company within the meaning of this title:

(1) * * *

* * * * * * *

[(10) Any company organized and operated exclusively for religious, educational, benevolent, fraternal, charitable, or reformatory purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.]

(10)(A) Any company organized and operated exclusively for religious, educational, benevolent, fraternal, charitable, or reformatory purposes—

(i) no part of the net earnings of which inures to the benefit of any private shareholder or individual; or

(ii) which is or maintains a fund described in subparagraph (B).

(B) For the purposes of subparagraph (A)(ii), a fund is described in this subparagraph if such fund is a pooled income fund, collective trust fund, collective investment fund, or similar fund maintained by a charitable organization exclusively for the collective investment and reinvestment of one or more of the following:

(i) assets of the general endowment fund or other funds of one or more charitable organizations;

(ii) assets of a pooled income fund;

(iii) assets contributed to a charitable organization in exchange for the issuance of charitable gift annuities;

(iv) assets of a charitable remainder trust or of any other trust, the remainder interests of which are irrevocably dedicated to any charitable organization;

(v) assets of a charitable lead trust;

(vi) assets of a trust not described in clauses (i) through (v), the remainder interests of which are revocably dedicated to a charitable organization, subject to subparagraph (C); or

(vii) such assets (including assets revocably dedicated to a charitable organization) as the Commission may prescribe by rule, regulation, or order in accordance with section 6(c).

(C) A fund that contains assets described in clause (vi) of subparagraph (B) shall be excluded from the definition of an investment company for a period of 3 years after the date of enactment of this subparagraph, but only if—

(i) such assets were contributed before the date which is 60 days after the date of enactment of this subparagraph; and

(ii) such assets are commingled in the fund with assets described in one or more of clauses (i) through (v) of subparagraph (B).

(D) For purposes of this paragraph—

(i) a trust or fund is "maintained" by a charitable organization if the organization serves as a trustee or administrator of the trust or fund or has the power to remove the trustees or administrators of the trust or fund and to designate new trustees or administrators;

(ii) the term "pooled income fund" has the same meaning as in section 642(c)(5) of the Internal Revenue Code of 1986;

(iii) the term "charitable organization" means an organization described in paragraphs (1) through (5) of section 170(c) or section 501(c)(3) of the Internal Revenue Code of 1986;

(iv) the term "charitable lead trust" means a trust described in section 170(f)(2)(B), 2055(e)(2)(B), or 2522(c)(2)(B) of the Internal Revenue Code of 1986;

(v) the term "charitable remainder trust" means a charitable remainder annuity trust or a charitable remainder unitrust, as those terms are defined in section 664(d) of the Internal Revenue Code of 1986; and

(vi) the term "charitable gift annuity" means an annuity issued by a charitable organization that is described in section 501(m)(5) of the Internal Revenue Code of 1986.

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TRANSACTIONS BY UNREGISTERED INVESTMENT COMPANIES

SEC. 7. (a) * * *

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(e) DISCLOSURE BY EXEMPT CHARITABLE ORGANIZATIONS.—Each fund that is excluded from the definition of an investment company under section 3(c)(10)(B) of this Act shall provide, to each donor to such fund, at the time of the donation or within 90 days after the date of enactment of this subsection, whichever is later, written information describing the material terms of the operation of such fund.

* * * * * * *

SECTION 3 OF THE SECURITIES ACT OF 1933

* * * * * * *

EXEMPTED SECURITIES

SEC. 3. (a) Except as hereinafter expressly provided, the provisions of this title shall not apply to any of the following classes of securities:

(1) * * *

* * * * * * *

(4) Any security issued by a person organized and operated exclusively for religious, educational, benevolent, fraternal, charitable, or reformatory purposes and not for pecuniary profit, and no part of the net earnings of which inures to the benefit of any person, private stockholder, or individual; *or any security of a fund that is excluded from the definition of an in-*

vestment company under section 3(c)(10)(B) of the Investment Company Act of 1940;

* * * * * * *

SECURITIES EXCHANGE ACT OF 1934

* * * * * * *

TITLE I—REGULATION OF SECURITIES EXCHANGES

* * * * * * *

DEFINITIONS AND APPLICATION OF TITLE

SEC. 3. (a) When used in this title, unless the context otherwise requires—

(1) * * *

* * * * * * *

(12)(A) The term "exempted security" or "exempted securities" includes—

(i) * * *

* * * * * * *

(iv) any interest or participation in a single trust fund, or a collective trust fund maintained by a bank, or any security arising out of a contract issued by an insurance company, which interest, participation, or security is issued in connection with a qualified plan as defined in subparagraph (C) of this paragraph; **[**and**]**

(v) any security issued by or any interest or participation in any pooled income fund, collective trust fund, collective investment fund, or similar fund that is excluded from the definition of an investment company under section 3(c)(10)(B) of the Investment Company Act of 1940; and

[(v)**]** *(vi)* such other securities (which may include, among others, unregistered securities, the market in which is predominantly intrastate) as the Commission may, by such rules and regulations as it deems consistent with the public interest and the protection of investors, either unconditionally or upon specified terms and conditions or for stated periods, exempt from the operation of any one or more provisions of this title which by their terms do not apply to an "exempted security" or to "exempted securities".

* * * * * * *

(e) CHARITABLE ORGANIZATIONS.—

(1) EXEMPTION.—Notwithstanding any other provision of this title, but subject to paragraph (2) of this subsection, a charitable organization, as defined in section 3(c)(10)(D) of the Investment Company Act of 1940, or any trustee, director, officer, employee, or volunteer of such a charitable organization acting within the scope of such person's employment or duties with such organization, shall not be deemed to be a "broker", "dealer", "municipal securities broker", "municipal securities dealer",

"government securities broker", or "government securities dealer" for purposes of this title solely because such organization or person buys, holds, sells, or trades in securities for its own account in its capacity as trustee or administrator of, or otherwise on behalf of or for the account of—

(A) such a charitable organization;

(B) a fund that is excluded from the definition of an investment company under section 3(c)(10)(B) of the Investment Company Act of 1940; or

(C) a trust or other donative instrument described in section 3(c)(10)(B) of the Investment Company Act of 1940, or the settlors (or potential settlors) or beneficiaries of any such trust or other instrument.

(2) LIMITATION ON COMPENSATION.—The exemption provided under paragraph (1) shall not be available to any charitable organization, or any trustee, director, officer, employee, or volunteer of such a charitable organization, unless each person who, on or after 90 days after the date of enactment of this subsection, solicits donations on behalf of such charitable organization from any donor to a fund that is excluded from the definition of an investment company under section 3(c)(10)(B) of the Investment Company Act of 1940, is either a volunteer or is engaged in the overall fund raising activities of a charitable organization and receives no commission or other special compensation based on the number or the value of donations collected for the fund.

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REGISTRATION REQUIREMENTS FOR SECURITIES

SEC. 12. (a) * * *

* * * * * * *

(g)(1) * * *

(2) The provisions of this subsection shall not apply in respect of—

(A) * * *

* * * * * * *

(D) any security of an issuer organized and operated exclusively for religious, educational, benevolent, fraternal, charitable, or reformatory purposes and not for pecuniary profit, and no part of the net earnings of which inures to the benefit of any private shareholder or individual*; or any security of a fund that is excluded from the definition of an investment company under section 3(c)(10)(B) of the Investment Company Act of 1940*.

* * * * * * *

SECTION 203 OF INVESTMENT ADVISERS ACT OF 1940

REGISTRATION OF INVESTMENT ADVISERS

SEC. 203. (a) * * *

(b) The provisions of subsection (a) shall not apply to—

(1) * * *

(2) any investment adviser whose only clients are insurance companies; **[**or**]**

(3) any investment adviser who during the course of the preceding twelve months has had fewer than fifteen clients and who neither holds himself out generally to the public as an investment adviser nor acts as an investment adviser to any investment company registered under title I of this Act, or a company which has elected to be a business development company pursuant to section 54 of title I of this Act and has not withdrawn its election. For purposes of determining the number of clients of an investment adviser under this paragraph, no shareholder, partner, or beneficial owner of a business development company, as defined in this title, shall be deemed to be a client of such investment adviser unless such person is a client of such investment adviser separate and apart from his status as a shareholder, partner, or beneficial owner**[**.**]***; or*

(4) any investment adviser that is a charitable organization, as defined in section 3(c)(10)(D) of the Investment Company Act of 1940, or is a trustee, director, officer, employee, or volunteer of such a charitable organization acting within the scope of such person's employment or duties with such organization, whose advice, analyses, or reports are provided only to one or more of the following:

(A) any such charitable organization;

(B) a fund that is excluded from the definition of an investment company under section 3(c)(10)(B) of the Investment Company Act of 1940; or

(C) a trust or other donative instrument described in section 3(c)(10)(B) of the Investment Company Act of 1940, or the trustees, administrators, settlors (or potential settlors), or beneficiaries of any such trust or other instrument.

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