

INTERNATIONALIZATION

of the Securities Markets

CHAPTER VI

**Investment Companies and Advisers
and the Internationalization
of the Securities Markets**

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CHAPTER VI

INVESTMENT COMPANIES AND ADVISERS AND THE INTERNATIONALIZATION OF THE SECURITIES MARKETS

A. Introduction

Investment companies and investment advisers have participated actively in the internationalization process. Since 1983, the number of domestic open-end investment companies that concentrate their portfolio investments in foreign securities has nearly tripled and the total assets of these companies have grown from \$3.5 billion to over \$14 billion as of the end of the fiscal year. The activities of foreign investment advisers in the U.S. also have increased: 127 foreign investment advisers from 20 countries have registered as investment advisers with the Commission.

Foreign participation in the U.S. investment company market, however, has been slow. The Investment Company Act of 1940 ("ICA") requires that foreign investment companies obtain an order of the Commission permitting them to register under the ICA and to make a public offering of their shares. The Commission may not issue the order unless it finds that special circumstances or arrangements make it legally and practically feasible to enforce the provisions of the ICA effectively against the company and that the order is consistent with the public interest and the protection of investors. Because of these strict statutory conditions, only nineteen orders allowing registration have been issued by the Commission since the adoption of the ICA. Consequently, the principal means by which foreign sponsors can bring an investment company product to the

U.S. market is by organizing a "mirror" fund in the U.S., under U.S. law.

U.S. investment companies also have experienced difficulties in marketing their shares abroad, for different reasons in different countries. The lack of uniformity among regulatory schemes makes it difficult for any single investment company, whether U.S. or foreign, to be marketed on an international basis.

The Commission staff is studying means to permit cross-border marketing of investment company shares, primarily through reciprocal agreements with foreign regulators. To explore this, the staff has developed contacts with foreign regulators and with international organizations of securities regulators. The staff initiative in this area is based on the premise that if the regulatory scheme of a foreign nation serves the same purposes as the ICA, it may be possible to rely upon foreign law for certain types of investor protection, rather than requiring that a foreign investment company comply with all the provisions of the ICA before offering shares in the U.S. Implementing this approach, however, might require Congressional action.

This chapter discusses the extent to which investment companies and investment advisers are participating in the internationalization process and summarizes the barriers that presently inhibit international activity. The chapter also describes steps taken by the Commission and staff to date to address these barriers.

B. Participation by Foreign and Domestic Investment Companies and Investment Advisers in the Internationalization of the Securities and Currency Markets

1. Participation In Foreign Markets by Domestic Institutional Investors

Increasingly, individual investors in the United States are using management investment companies of the open-end ("mutual funds") and closed-end types as a means of participating in the securities markets. ^{1/} By investing in these funds, investors of modest means can attain a level of diversification and professional management that otherwise would be unavailable to them. As the securities markets have become more global in scope, funds have been organized with investment policies that require or allow a significant portion of fund assets to be invested in securities of foreign issuers. These funds allow U.S. investors to invest in foreign securities without the costs and administrative burdens of conducting transactions directly in foreign markets.

The growth in the number and assets of funds that invest abroad is demonstrated by data compiled by the Investment Company Institute ("ICI"), a trade association for the U.S. mutual fund industry. In 1983, there were 21 mutual funds that had investment objectives specifically requiring the investment of all or part of fund assets outside the United States. These 21 funds had total

^{1/} While U.S. investors also are investing in unit investment trusts ("UITs"), participation by UITs in the internationalization process has been limited. UITs are open-end investment companies that invest in a fixed, rather than a managed, portfolio of securities.

assets of approximately \$3.5 billion. By December 1985, there were 42 such funds with assets of approximately \$8 billion. As of September 1986, the number of mutual funds investing abroad had grown to 53, with assets of approximately \$14.7 billion. The ICI figures on investment abroad do not include closed-end funds, mutual funds that concentrate their investments in the securities of companies that mine precious metals, or unit investment trusts. Commission records indicate that, as of October 29, 1986, 114 investment companies of all types that invest or intend to invest abroad had registered or were in the process of registering under the ICA. Of these, the 97 funds that were operating and for which information was available had total assets of approximately \$23.5 billion, with an average 78.4% of each fund's assets invested in foreign securities.

In addition to investment companies, other pooled investment vehicles, such as employee benefit plans, are investing increasingly outside the United States. According to surveys of the fifty largest international investment advisers conducted by Pensions and Investment Age, a trade publication, as of March 31, 1987, U.S. tax-exempt assets invested abroad totalled approximately \$37.0 billion. This amount was invested primarily in equity (\$32.6 billion) and fixed income (\$4.7 billion) securities. The total figure for such investment abroad represented an increase of 13.5% over the \$32.6 billion total invested abroad by tax-exempt entities as of March 31, 1986 and 133% over the \$15.9 billion

total invested abroad by tax-exempt entities as of March 31, 1985. 2/

2. Participation by Foreign Institutional Investors in the U.S. Securities Markets

In the past few years participation by non-U.S. investment advisers in the United States securities markets also has increased. One measure of this increase is the number of non-resident institutional investment managers required to file Form 13F with the SEC. 3/ A review of Form 13F filings for the calendar quarters between the first quarter of 1981 and the third quarter of 1986 indicates that the number of foreign 13F filers increased dramatically in late 1985 and 1986 after remaining relatively constant between

2/ See International, Global Assets, Pensions and Investment Age (June 29, 1987) at page 35; Overseas Assets Rose to \$32.6 Billion, Pensions and Investment Age (August 4, 1986) at page 15. See also International Equities' Dilemma: How do you top 1985? Pension World, Vol. 22 No. 4 (April, 1986) at page 26.

3/ Under Section 13(f) of the Securities Exchange Act of 1934 and Rule 13f-1, 17 CFR 240.13f-1, each institutional investment manager that uses the instrumentalities of interstate commerce in its business and that exercises investment discretion over certain equity securities ("13(f) securities") having an aggregate fair market value of \$100 million (as of the last trading day of any month of a given calendar year) must file Form 13F with the SEC. The form discloses information such as the identity, number and market value of the 13(f) securities that are subject to the manager's discretion.

1981 and 1985. 4/ This increase reveals that a growing number of foreign institutional investment managers are exercising investment discretion over U.S. equity securities. 5/

4/ This is summarized in the following chart:

<u>Quarter</u>	<u>Total 13F Filers</u>	<u>Foreign 13F Filers</u>
1-81	786	227
2-81	804	239
3-81	727	201
4-81	774	222
1-82	804	210
2-82	791	204
3-82	783	202
4-82	821	209
1-83	829	205
2-83	857	205
3-83	869	199
4-83	884	213
1-84	926	211
2-84	999	219
3-84	896	199
4-84	880	190
1-85	971	228
2-85	996	254
3-85	977	260
4-85	1,020	284
1-86	982	332
2-86	1,025	377
3-86	1,032	399

5/ Data is not available on the total number of foreign managers exercising investment discretion over U.S. equity securities or the total value of the securities subject to their discretion. The total value of 13(f) securities reported by the 399 foreign managers filing Form 13F for the third quarter of 1986 has not been compiled, but would represent discretion over at least \$39.9 billion in 13(f) securities by these managers. Foreign institutional investment managers with investment discretion over less than \$100 million in 13(f) securities are not required to file Form 13F.

The increasing participation of foreign investment advisers in the U.S. securities markets also is demonstrated by the number of advisers that have registered under the Investment Advisers Act of 1940 ("IAA"). 6/ Commission records indicate that 127 foreign investment advisers from 20 countries have registered under the IAA. This number does not include registered investment advisers domiciled in the U.S. that are affiliated with foreign investment advisers, such as U.S. subsidiaries of foreign advisers. These advisers are considered domestic advisers.

Although foreign advisers have become more active in U.S. securities markets, participation by foreign investment companies has been slow. Foreign investment companies cannot publicly offer their shares in the U.S. without registering under the ICA and only five active foreign investment companies, four Canadian and one

6/ Sections 202(a)(11) and 203(a) of the IAA generally require a foreign investment adviser to register if the adviser (1) engages, for compensation, in the business of advising others as to the value of securities or as to the advisability of investing in, purchasing, or selling securities or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities; and (2) uses the mails or any instrumentality of interstate commerce in connection with such advisory business. As defined in Section 202(a)(10) of the IAA, the term "interstate commerce" includes "trade, commerce, transportation, or communication . . . between any foreign country and any State" The SEC staff, on a number of occasions, has indicated that nonresident foreign investment advisers that have no U.S. clients but simply use the instrumentalities of interstate commerce in connection with their foreign advisory business need not register under the IAA. See, e.g. Double D. Management, Ltd. (pub. avail. Jan. 31, 1983). For a more detailed review of SEC and staff positions relating to the applicability of the IAA to foreign investment advisers, see Judd, International Investment Advisers, 19 Securities and Commodities Regulation 1 (Jan. 8, 1986).

South African, are presently registered. The small number of registered foreign investment companies is attributable to Section 7(d) of the ICA which, as discussed in the next section, inhibits foreign investment companies from registering under the ICA. However, the Commission staff takes the position that Section 7(d) does not prevent an unregistered foreign investment company from making a private offering of its securities in the U.S., so long as it has and will have no more than 100 U.S. shareholders. 7/ This position is based on an analogy to Section 3(c)(1) of the ICA, which exempts from the definition of an "investment company" any issuer whose outstanding voting securities are beneficially owned by fewer than 100 persons and that is not making and does not propose to make a public offering of its securities. Because foreign companies relying on this position are not required to register under the ICA, the staff cannot determine the number of foreign investment companies privately offering their shares in the U.S. 8/

7/ See Touche Remnant & Co. (pub. avail. Aug. 27, 1984).

8/ A foreign investment company making a private placement of its securities in the U.S. could rely on the "safe harbor" from the registration of those securities provided by Regulation D under the Securities Act of 1933. However, a company relying on Regulation D would have to file Form D with the Commission. A recent review of Form D filings did not indicate any filings by foreign investment companies.

C. Regulatory Limitations on the Participation of Investment Companies in International Securities Markets

1. Barriers Confronting Foreign Investment Companies Seeking to Issue Shares in the U.S.

Section 7(d) of the ICA prohibits an investment company that is not organized under the laws of the United States or of a State of the United States from publicly offering securities in this country unless it obtains an order from the Commission under Section 7(d). That section authorizes the Commission to allow a foreign investment company to register under the ICA if the Commission finds that (1) by reason of special circumstances or arrangements, it is both legally and practically feasible to enforce effectively the provisions of the ICA against the applicant; and (2) the issuance of an order is otherwise consistent with the public interest and the protection of investors.

In the early 1950's, several investment companies organized in Canada sought permission under Section 7(d) to register under the ICA and offer their securities in the United States. Based on its review of these applications, in 1954 the Commission adopted Rule 7d-1 under the ICA which sets forth the minimum conditions and undertakings necessary for a Canadian investment company to obtain an order under Section 7(d). ^{9/} The rule requires, among other things, that: (1) fund assets and records be kept in the

^{9/} Rule 7d-1 [17 CFR 270.7d-1] was proposed in Investment Company Act Release No. 1945 (Jan. 28, 1954) and adopted in Investment Company Act Release No. 1973 (Apr. 27, 1954).

U.S., (2) the fund charter and by-laws contain in substance, certain specified provisions of the ICA and be enforceable in the U.S., and (3) a majority of the fund's officers and directors be U.S. citizens, with a majority of the U.S. citizens resident in the U.S.

From 1954 to 1973, the Commission issued exemptive orders under Section 7(d) to nineteen foreign investment companies. Thirteen of these funds were Canadian and the other six were organized under the laws of countries with common law traditions. 10/ All of the funds that received orders complied with the substantive provisions of Rule 7d-1.

To explore standards for permitting registration of foreign investment companies under the ICA, the Commission requested public comment on these issues in 1974. 11/ The Commission asked for comment on whether the Standard Rules formulated by the Organization for Economic Cooperation and Development ("OECD") to provide minimum requirements for mutual funds could be the basis for permitting foreign funds to issue their shares in the U.S. The Standard Rules, which are discussed below, were developed in 1972 after extensive deliberation by OECD member nations including the U.S.

10/ The other orders were issued to two funds organized in Australia, two in Bermuda, one in South Africa and one in the United Kingdom. Of the nineteen funds that received orders, only five are presently active. Four of these are Canadian and one is South African.

11/ See Investment Company Act Release No. 8596 (Dec. 2, 1974).

Many of the commentators that discussed the OECD Standard Rules expressed the opinion that decisions on whether foreign investment companies should be allowed to sell their shares in the United States should be made on a case-by-case basis, and should not be based solely on compliance with the minimum requirements embodied in the Standard Rules because the provisions of the Standard Rules are, in many respects, less stringent than those of the ICA. These commentators believed that foreign investment companies allowed to issue their shares in the U.S. while complying only with foreign regulations might have a competitive advantage over U.S. funds complying with the ICA. Additionally, one commentator suggested that if foreign investment companies were not required to comply with certain requirements of the ICA, domestic corporations might reorganize under foreign law to circumvent those ICA requirements. After considering the comments the Commission concluded that, in light of the specific requirements of Section 7(d), it should continue to determine whether foreign investment companies could register under the Act on a case-by-case basis. To provide guidance to potential applicants the Commission issued a release discussing the minimum prerequisites for a foreign investment company to obtain an order under Section 7(d). 12/

12/ See Investment Company Act Release No. 8959 (Sept. 26, 1975).

In 1977, the Commission began to review a draft application, submitted formally in 1980, for registration under the ICA of a fund organized in a civil law country. The application of Union-Investment-Gesellschaft m.b.h. (Union-Investment"), an investment management firm in the Federal Republic of Germany ("FRG"), for a Commission order under Section 7(d) to allow Unifonds, a mutual fund in the FRG, to register under the ICA, presented many novel and difficult issues because of significant differences between investment company regulation in the FRG and the U.S. In spite of extensive efforts, the Commission was unable to resolve the issues raised by the Unifonds application in a manner that satisfied the requirements of Section 7(d) and, in 1983, Union-Investment withdrew the application.

As a result of the problems presented by the Unifonds application, the Commission issued another release in 1983 suggesting that foreign investment companies could avoid the problems presented by Section 7(d) by registering a "mirror fund." A mirror fund is an investment company organized under the laws of the United States to invest primarily in the same securities in which an existing foreign investment company invests. 13/

Additionally, in January, 1984, the Commission transmitted to Congress a recommendation to amend Section 7(d) of the ICA to allow the Commission to permit foreign investment companies to

13/ See Investment Company Act Release No. 13691 (Dec. 23, 1983).

register under the ICA and publicly offer their shares in the U.S. under certain circumstances. Specifically, the Commission sought authority to exempt certain operating foreign investment companies from provisions of the ICA if the Commission finds that, given the nature of the foreign company, compliance with those provisions would be unduly burdensome and either that the foreign law under which the company operates provides protections for investors that serve the same purposes as the protections provided by those provisions of the ICA from which exemptions are sought, or that such investor protection is provided by specific conditions agreed to by the company. Also, the Commission would be required to find that the exemption is consistent with the protection of investors and the purposes intended by the policy of the ICA and that the foreign company is not operated for the purpose of evading the provisions of the ICA. In the memorandum accompanying the proposal, the Commission stated that it based its recommendations on the notion that, given the growing internationalization of the securities markets, the present requirements of Section 7(d) operate to unreasonably impede the natural development of international markets and competition. To date, the proposal has not been introduced in either House of Congress.

2. Barriers Confronting U.S. Investment Companies Seeking to Issue Shares Abroad

Although it has become more common for investment companies registered under the ICA to issue their shares in foreign countries,

a number of factors still discourage U.S. funds from marketing their shares abroad. These include the burden of complying with foreign regulations in addition to U.S. regulations, 14/ and the relatively small number of potential shareholders in many foreign countries. However, as foreign governments relax regulatory barriers to the sale of U.S. fund shares within their boundaries and the foreign markets for such shares grow, it is likely that additional U.S. companies will seek to market their shares outside the United States. 15/

Historically, many foreign countries have imposed restrictions to prevent or limit the flow of capital across their borders to other countries. An example is the foreign exchange controls that govern transactions by Italian citizens in foreign securities. Until recently, Italians investing abroad were required to deposit fifty percent of the value of any foreign securities purchased into

14/ The Commission has taken the position that an open-end investment company registered under the ICA that sells its shares outside the United States is required to comply with substantially the same disclosure requirements with respect to foreign investors as would be required for domestic investors. See Investment Company Act Release No. 6082 (June 23, 1970).

15/ A more detailed country-by-country analysis of foreign mutual fund regulation, together with a broader discussion of the regulatory treatment of U.S. banking and securities firms by specific foreign countries, is contained in the 1986 Update to the September 1979 "National Treatment Study: Report to Congress on Foreign Government Treatment of U.S. Commercial Banking and Securities Organizations" ("1986 Update"), which was submitted to the Senate Committee on Banking, Housing and Urban Affairs by the Department of the Treasury in December 1986.

a non-interest bearing account. 16/ Another example is provided by the French laws requiring French residents to hold any foreign securities purchased abroad within France and to repatriate the proceeds of overseas securities trading to France within three months. Moreover, until May 1986, French residents seeking to purchase foreign securities were required to obtain the foreign currency necessary to do so at a premium on a foreign exchange market specifically designated for buyers and sellers of foreign securities. 17/

In addition to regulations designed to discourage residents from investing abroad, many foreign countries have imposed licensing and other requirements on foreign investment companies that, in some cases, are stricter than those placed on domestic funds. Even where compliance with a particular country's regulations is not burdensome, many U.S. investment companies prefer to sell shares solely in the U.S. This preference may result because in order to have access to a large enough market of potential investors, a fund may have to offer its shares in several foreign countries. Because the regulatory schemes of foreign nations generally have not been compatible with each other or with the ICA, compliance with several regulatory schemes becomes onerous, even though complying with the requirements of any one nation might not be burdensome.

16/ This deposit requirement recently has been reduced to fifteen percent of the value of the securities purchased. See 1986 Update at 210.

17/ See 1986 Update at 199.

Nevertheless, a number of developments have occurred that could make foreign markets more accessible and attractive to U.S. investment companies. First, as noted above and discussed in more detail in the 1986 Update, many foreign nations are relaxing regulation of investment companies organized in other countries. Second, the market for investment company shares in many foreign countries is expanding as the securities markets in those countries mature and collective investment vehicles such as mutual funds become more attractive to individual investors. For instance, since the organization of mutual funds in Italy was authorized in 1983, there has been a rapid growth in the number and size of such funds. By April 1986, forty-eight mutual funds had been established in Italy 18/ and, by July 1986, approximately one and a half million Italian residents had invested more than \$25 billion in mutual funds. Since this amount represents only a small percentage of the \$466 billion in total savings held by Italians, the potential market for fund shares in Italy is quite large. 19/ The growing popularity of mutual funds in Italy and other countries is likely to attract U.S. fund sponsors to foreign markets, despite regulatory barriers.

18/ See 1986 Update at 209.

19/ See Markin, Fund Mania, Italian Style, Institutional Investor (International Edition) (July 1986) at 80.

D. Recent Initiatives Relating to Investment Company Participation in the Internationalization Process

1. The Possibility of Reciprocal Arrangements Between the United States and Foreign Nations or Organizations with Respect to Multinational Offerings of Mutual Fund Securities

The Commission has received inquiries regarding the possibility of bilateral arrangements between the U.S. and foreign governments to allow mutual funds registered in one country to sell their shares in the other country without meeting additional compliance measures. Commission staff have met informally with Japanese and Canadian securities regulators to discuss the possibility of reciprocal arrangements.

Bilateral agreements to achieve reciprocity would require that the United States negotiate a separate agreement with each nation. As an alternative, the Commission staff is exploring the possibility of achieving reciprocity for the sale of fund shares by an agreement with an international organization such as the European Economic Community ("EEC") or the OECD. This approach has been supported by representatives of the U.S. mutual fund industry and by the European Federation of Investment Funds and Companies, which is comprised of mutual fund trade associations from nine European countries. Under this approach, foreign mutual funds would be allowed to issue securities in the U.S. as long as the funds were organized under the laws of a country that had implemented a set of regulatory standards approved by the international organization. Funds complying with the provisions of the ICA would be able to

issue securities in member nations of the international organization that had implemented the regulatory standards. The EEC Council Directive 85/611/EEC "on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)" (the "Directive"), and the "Standard Rules for the Operations of Institutions for Collective Investment in Securities" (the "Standard Rules") proposed by the OECD could serve as the basis for such a reciprocal arrangement. However, as discussed below, neither the Directive nor the Standard Rules provide a regulatory framework directly comparable to that of the ICA. Therefore, any negotiations for a reciprocal agreements based on either the Directive or the Standard Rules would have to address the differences between those regulatory guidelines and the ICA.

The EEC Directive was adopted on December 20, 1985 to facilitate marketing within the EEC of certain collective investment products, while ensuring a minimum level of investor protection. The products covered are roughly equivalent to open-end, management, diversified registered investment companies under the ICA. The Directive provides that EEC Member Nations must conform their laws to its terms by October 1989. Although it is not certain that all EEC member nations will comply with this deadline, the Directive represents a significant step toward eliminating regulatory barriers to multinational offering of securities by mutual funds organized in EEC member nations. The Directive could provide a starting point

for negotiations between the United States and the EEC with respect to a treaty allowing reciprocal sales of mutual fund shares.

The Directive is not self-operative, but depends on the enactment by EEC members of implementing legislation and regulations. While it contains provisions relating to the organization, structure, management, authorization, business practices and investment policies of diversified mutual funds, the Directive allows EEC member nations some flexibility to structure the regulation of these funds within their borders. Member states may define a category of fund that would be exempt from all provisions of the Directive upon a finding that the rules in the Directive relating to investment and borrowing policies are inappropriate for that category. The Directive also grants member states broad discretion to modify the provisions relating to diversification of assets and to regulate any area not addressed in the Directive. For these reasons, it is not expected that the Directive will result in EEC members having identical regulatory schemes for diversified mutual funds.

Nevertheless, the Directive should result in certain minimum standards for diversified mutual funds throughout the EEC. These standards include requirements that: (1) directors of the management company be of good repute and have sufficient experience to perform their duties (Article 4); (2) fund assets be maintained in the custody of a depository subject to public control (Articles 7 and 8); and (3) management companies limit their activities to the management of unit trusts and investment companies (Article 6).

Additionally, member nations must enact legislation to ensure that the entities involved with these funds are financially able to conduct business effectively and meet their liabilities, and to otherwise satisfy the goals of the Directive with respect to the protection of shareholders. Finally, the Directive would require each fund to publish a prospectus that includes the minimum information necessary for investors to make an informed judgment as to the investment proposed to them, and annual and semi-annual reports that would include financial statements.

There are a number of significant differences between the regulatory scheme of the Directive and that of the ICA. The Directive contains no provisions, comparable to Sections 17 and 10(f) of the ICA, that explicitly address the question of affiliated transactions 20/ or limit the ability of a fund to acquire portfolio securities during the existence of an underwriting or selling syndicate where an officer, director, advisory board member, investment adviser or employee of the fund, or any affiliated person or such persons, is acting as a principal underwriter for the issuer of the security. Other differences could arise as a result of implementing legislation and regulations enacted by EEC member nations. It would be possible for such legislation to conflict with the type of regulation provided for in the ICA,

20/ Such transactions may be addressed implicitly by the provisions of the Directive requiring depositories, which handle all asset transactions, to act solely in the interests of shareholders (Article 17).

while still complying with the general regulatory framework provided by the Directive. For instance, under the Directive a member nation could allow fund assets to be maintained in a depository that would not qualify as a custodian of investment company assets under Section 17(f) of the ICA. Also, because the Directive leaves to the member states regulation of retail pricing of fund shares, a member state could allow fund shares to be priced in a manner inconsistent with Section 22 of the ICA and Rule 22c-1 thereunder, which require that the issuance and redemption price of mutual fund shares be based on the fund's net asset value per share next calculated after receipt of a purchase or redemption order.

The Standard Rules formulated by the OECD also might form the basis for a reciprocal arrangement. These rules were developed in 1972 after extensive deliberation by representatives of the member nations of the OECD, including the United States. ^{21/} The Standard Rules were intended to provide minimum requirements for the investment management and marketing practices of, and the protection of investors in, collective investment institutions, defined as roughly comparable to open-end investment companies under the ICA. The Standard Rules were not intended to supplant

^{21/} At that time, the members of the OECD were Australia, Austria, Belgium, Canada, Denmark, Finland, France, the Federal Republic of Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, The Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The Commission provided one of the United States representatives.

the ability of OECD members to regulate the sale of securities of foreign funds within their borders but only to provide OECD member nations with a starting point for developing parallel regulations. In this regard, the OECD specifically recognized that members could impose regulatory requirements in addition to those contained in the Standard Rules.

Many provisions of the Standard Rules are either less restrictive than those of the ICA or give member countries the discretion to be less restrictive. For example, the Standard Rules provide that the title to fund assets must be held in a manner acceptable to the appropriate supervisory authority; Section 17(f) of the ICA specifically requires funds to maintain securities and similar investments in the custody of a bank, a member firm of a national securities exchange, or the investment company itself in accordance with Commission rules. 22/ Additionally, because the term "bank," as defined in the ICA, does not include a foreign bank, an investment company requires exemptive relief from the ICA in order to maintain its portfolio securities in the custody of a foreign bank. 23/ The

22/ Rule 17f-2 under the ICA requires an investment company acting as a self-custodian to deposit its securities and similar investments in the safekeeping of a bank or other company whose functions and physical facilities are supervised by federal or state authorities.

23/ Rule 17f-5 provides exemptive relief for management investment companies to maintain their assets outside the U.S. in the custody of an "eligible foreign custodian," which includes a foreign bank that has shareholders' equity in excess of \$200 million.

Standard Rules give OECD members similar flexibility in other areas that are subject to specific statutory and regulatory restrictions under the ICA. These include: (1) valuation of investment company assets; (2) the frequency for valuing and pricing fund shares; and (3) the time period in which to honor redemption requests.

Following the promulgation of the Standard Rules, the OECD recommended, with the support of the Commission, that each member nation (1) review its existing legislation and regulations in light of the Standard Rules; (2) consider the Standard Rules when preparing new legislation or regulations; and (3) give substantial weight, within the framework of its legislation, to the fact that a foreign fund applying for permission to offer securities within that member nation has complied with the Standard Rules. As discussed above, the Commission sought comment in 1974 on whether compliance with the Standard Rules could be the basis, under Section 7(d) of the ICA, to permit a foreign fund to operate in the U.S. Although the Commission determined in 1975 to continue to consider Section 7(d) applications on a case by case basis, it may be appropriate to reexamine the Standard Rules as a possible basis for negotiation of a reciprocal arrangement, and amendment to section 7(d), to facilitate cross-border marketing of mutual funds.

Whether it would be possible to negotiate a reciprocal arrangement to allow U.S. investment companies to issue their securities abroad and foreign investment companies to issue their securities

in the United States will depend upon a number of factors. Under the EEC Directive and the OECD Standard Rules, members could enact regulatory requirements in certain areas that are less stringent than those of the ICA. Allowing foreign funds to issue shares in the United States while complying only with foreign standards may not provide U.S. investors in a foreign investment company with the level of protection available to investors in an investment company that is complying with the requirements of the ICA. Such an action could also place U.S. investment companies at a competitive disadvantage to foreign funds. Accordingly, any reciprocal treaty should seek to ensure that (1) U.S. investors in foreign investment companies selling shares in the United States receive protection that is comparable to that received by investors in investment companies organized in the U.S. and operated in accordance with the ICA, and (2) U.S. investment companies are not placed at a competitive disadvantage to foreign investment companies, whether in the United States or abroad.

2. Easing Restrictions on the Ability of Foreign Banks to Issue Securities in the U.S.

Recently, the Commission has taken steps to facilitate U.S. offerings of securities by foreign banks. Under the ICA foreign banks may be precluded from offering their securities in the U.S. in the absence of a Commission exemption. A foreign bank is considered an investment company under the ICA to the extent that it is involved in owning, holding, trading, investing or reinvesting

in securities. 24/ Although Section 3(c)(3) of the ICA specifically excepts U.S. banks from the definition of investment company, that exception does not extend to foreign banks. Therefore, before offering securities in the U.S., a foreign bank or its finance subsidiary must either register as an investment company or apply to the SEC for an exemptive order.

During the past six years, the SEC has granted an average of 20 exemptive orders annually to foreign banks and their finance subsidiaries to permit them to offer or sell their debt securities in the United States without registering under the ICA. On September 10, 1986, the Commission proposed Rule 6c-9 under the ICA to remove the requirement that foreign banks obtain individual exemptive orders. The proposed rule generally would permit a foreign bank or its finance subsidiary to offer or sell its own debt securities or non-voting preferred stock in the U.S. without registering as an investment company if (1) the securities are registered under the Securities Act of 1933, or (2) where the issuer can rely on an exemption from such registration, the securities are assigned one of the two highest ratings available from at least two nationally recognized statistical rating organizations. Proposed Rule 6c-9 also would require that (1) any securities offered or sold by a finance subsidiary of a foreign bank be unconditionally guaranteed by its parent; (2) any convertible or exchangeable securities be

24/ See Investment Company Act Release No. 15314 (Sept. 17, 1986).

convertible or exchangeable only for securities issued by a finance subsidiary's parent or for other debt or non-voting preferred stock of the subsidiary; (3) a finance subsidiary remit at least 85% of the offering proceeds to its parent no later than six months after receipt; (4) a subsidiary not invest the offering proceeds in securities other than government securities, 25/ commercial paper or securities issued by its parent or a company under common control; and (5) any foreign bank or non-U.S. subsidiary of a foreign bank relying upon the rule file a form with the Commission appointing an agent in the U.S. for service of process.

In 1986, the Commission for the first time permitted foreign banks to issue equity securities in the United States without registration under the ICA. Westpac Banking Corporation, an Australian bank, and Barclays PLC and National Westminster Bank PLC, British bank holding companies, were granted orders of exemption under Section 6(c) of the ICA, 26/ subject to several conditions.

25/ The term "government security" is defined in Section 2(a)(16) of the ICA as any security issued or guaranteed as to principal or interest by the United States, or by a person controlled or supervised by and acting as an instrumentality of the government of the United States pursuant to authority granted by Congress, or any certificate of deposit for any such securities.

26/ Section 6(c) of the ICA gives the Commission authority, by rules and regulations upon its own motion or by order upon application, to conditionally or unconditionally exempt any person, security or transaction or any class of persons, securities or transactions from any provisions of the ICA or regulations under the ICA upon a finding that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the ICA.

The conditions included that the foreign banks have a substantial presence in the United States and be regulated as banks both in their home country and in the United States. 27/

27/ See notices of application and orders for Westpac Banking Corporation, Investment Company Act Release Nos. 15181 (June 27, 1987) and 15217 (July 23, 1986); Barclays PLC, Investment Company Act Release Nos. 15189 (July 2, 1986) and 15228 (July 29, 1986); and National Westminster Bank PLC, Investment Company Act Release Nos. 15211 (July 18, 1986) and 15248 (August 12, 1986).