THE CHAIRMAN

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

February 13, 1995

Mr. Arie Mientkavich
Chairman
Israel Securities Authority
3, Kanfe Nesharim St.
Jerusalem 95464 ISRAEL

Dear Arie:

As I mentioned in my December 20, 1994 letter, I am pleased to provide you with my comments about Israel's new Mutual Investment Law. I find Israel's new law intriguing, even if the Commission's approach in striving for the same goal is different. The following discussion is intended to provide you with an understanding of the SEC's approach in dealing with the issues addressed by Israel's new law.

Historically, U.S. mutual funds have not been active participants in the corporate governance of their portfolio companies. Some commentators have suggested that provisions of the Investment Company Act of 1940 ("Investment Company Act") and U.S. tax laws effectively prevent mutual funds from being active shareholders. 1/ The Investment Company Act, however, specifically does not prohibit funds from being active shareholders. Funds may, for example, engage in a variety of shareholder activities such as communicating with other shareholders, sponsoring shareholder resolutions, announcing support of or opposition to management of a company, meeting with a company's executives, soliciting proxies or engaging in proxy fights.

1/ The Investment Company Act imposes broad prohibitions on dealings between investment companies and their affiliates without advance Commission approval. The definition of "affiliated person" includes any company that owns 5% or more of the shares of another company. Therefore, a portfolio company easily could become an affiliate of an investment company, making many types of business dealings between them problematic. In addition, both the Investment Company Act and our tax laws encourage investment companies to hold diversified portfolios, making investment for control difficult. Failing to meet the requirements of our tax laws, in particular, could result in taxation at both the investment company and the shareholder level, making the investment company a less attractive investment vehicle.

As you probably are aware, U.S. mutual funds typically are structured as corporations or business trusts governed by boards of directors or trustees. Under the Investment Company Act, the board of a fund has general oversight responsibilities regarding the activities of the fund, and has a duty to ensure that the fund's investment adviser manages the fund's assets in the best interests of the fund's shareholders. At a March 21, 1994 conference attended by counsel to, and officers and directors of, mutual funds, I discussed the role of mutual fund directors and trustees in corporate governance issues. In particular, I urged directors and trustees to look carefully at whether it is in the interest of investors that a fund exercise its franchise on matters as critical as anti-takeover measures and proxy fights for control of a portfolio company. We recognize that, because of cost concerns, mutual funds that are diversified broadly cannot take an active role with respect to every portfolio company or every matter submitted to shareholders. Nonetheless, when a shareholder vote raises issues that are tied directly to a stock's price, the case for involvement may be stronger. At the conference, I encouraged fund boards to ask their funds' investment managers about the system they have for identifying issues that might necessitate shareholder activism, and how voting decisions are made. With board encouragement, many more mutual fund managers actively should be considering how to vote their interests in portfolio companies.

We have sought to facilitate shareholder activism not only through speeches and discussion with fund boards and managers, but also through the adoption of certain rules. In particular, in 1992, the Commission adopted new rules that have lowered significantly the cost of proxy activism for institutional investors and have facilitated increased shareholder activism by institutional investors. 2/ U.S. institutional investors, including mutual funds, increasingly have become active shareholders, particularly when the benefits -- increasing financial returns without taking large risks or unduly sacrificing liquidity -- exceed the expected costs. In a recent and well publicized case, for example, Fidelity Investments, which advises several mutual funds that hold debt of R.H. Macy & Co., has been very vocal in the company's reorganization. Fidelity also played a pivotal role in increasing the price of the Hong Kong and Shanghai Bank's buyout offer of Marine Midland Bank. Fidelity Capital & Income Fund frequently exerts influence in bankruptcy reorganizations by taking large debt or equity positions in portfolio companies. A few years ago, another asset manager, Eagle Asset Management, actively organized opposition to a proposed merger of Centel Corp. and Sprint Corp. In general, I am encouraged by the increased participation of U.S.

2/ Under the new rules, a mutual fund or other institutional investor, without making any filings with the Commission or any mailings, may discuss voting issues with an unlimited number of other shareholders as long as the fund does not solicit proxies from any of the other shareholders. The new rules also allow institutional investors to solicit proxies from not more than ten shareholders without mailing a proxy statement to all shareholders.

mutual fund investment advisers in the affairs of their portfolio companies under the voluntary framework created by the Investment Company Act. 3/

I hope that the foregoing provides you with some useful insight into the SEC's approach in dealing with the issues raised by Israel's new Mutual Investment Law. I look forward to hearing more about your experience under the new law and the effects it has over the long run on the participation of mutual fund managers in company affairs.

Sincerely,

Arthur Levitt

3/ Other institutional investors, such as pension funds, also have participated actively in the affairs of their portfolio companies. The California public pension fund, CALPERS, is known for its frequent shareholder activism. It has targeted several well-known public companies, trying to improve management's performance and thus increase shareholder value.