

## COMMENT LETTER

March 21, 1997

# Comment Letter with USTR on Trade Issues, March 1997

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Frederick L. Montgomery, Chairman  
Trade Policy Staff Committee  
Office of the United States Trade Representative  
600 17th Street, NW  
Washington, DC 20508

Dear Chairman Montgomery:

The Investment Company Institute<sup>1</sup> appreciates the opportunity to comment on the issues the Institute and its members recommend be addressed in connection with the negotiation of a "Free Trade Area of the Americas" by 2005. Institute members have an interest in obtaining market access to asset management industries in the Americas and the ability to invest more freely in securities in these countries on behalf of their US mutual fund and other clients.

## Background

The investment management industry has become a global business. Mutual funds increasingly are the investment of choice for consumers around the world. Total mutual fund assets have grown dramatically in the US from about \$716 billion at the end of 1986 to over \$3.6 trillion today. Similar growth has occurred throughout the world. Investment company assets outside the US have increased from under \$1 trillion in 1988 to \$2.5 trillion at the end of 1995. The world-wide growth of mutual fund assets is expected to continue as the number of middle class consumers increases in both developed and developing countries and the baby boom generation enters its peak savings years. While one in three US households owns mutual funds, penetration ratios outside the US are lower. In France and the UK, only one in ten households currently owns mutual funds and penetration ratios are even lower in much of the rest of the world.

In addition, a growing portion of US mutual fund assets is invested abroad. Total assets of international and global equity and bond funds have grown to over \$321 billion. New sales of these funds were over \$45 billion during 1996.

The US mutual fund industry is a model for the rest of the world. As a result of the strict investment company regulatory regime administered by the US Securities and Exchange

Commission, the absence of barriers to entry in the US, and a regulatory and business environment that accommodates innovation in product design and distribution, the US mutual fund industry has earned investor confidence for providing quality investment management services at reasonable cost. The US money management industry would like to be able to take this success abroad by freely marketing its services and products outside the US.

Specifically, Institute members would like to: (1) invest freely abroad on behalf of US mutual funds and other clients; and (2) create affiliates in markets abroad to sponsor and distribute domestic mutual funds in those markets and manage non-US pension assets.

It is far easier for foreign firms to enter the US market than it is for US firms to market pension and mutual fund services abroad. Foreign investment advisers seeking to do business in the US receive unconditional national treatment. It is easy to register with the SEC as an investment adviser, and, once a foreign firm is registered, it can sponsor and advise US mutual funds and advise non-fund clients, such as US corporate and governmental pension plans. Foreign advisers can offer their services to US clients on a non-resident, cross-border basis, i.e., they do not have to maintain an office and staff in the US. In addition, the SEC has taken steps to facilitate the entry of foreign advisers into the US market.<sup>2</sup> As a result, foreign advisers have entered the US by acquiring existing US firms, by establishing affiliates in the US or by registering with the SEC as non-resident investment advisers.<sup>3</sup>

In contrast, many countries impose barriers that prevent US money managers from marketing their services and products in those countries. These barriers include laws or regulations limiting foreign firms to holding only a minority interest in a domestic money management firm and arbitrarily high capital or personnel staffing requirements.

In addition, many countries restrict the amount of securities of domestic issuers that can be owned by foreigners or impose other difficult conditions on investment, such as advance licensing requirements, or impose restrictions on repatriation of capital or onerous capital gain taxes or filing requirements.

## **US Objectives for FTAA Process**

The Institute recommends that the United States use the FTAA process to seek commitments from countries in the Hemisphere to remove barriers that impede investment by US mutual funds in the securities markets of the Hemisphere and that prevent US money management firms from providing asset management services to mutual funds and pension funds in the Hemisphere. The specific market access goals of the US asset management industry in the Hemisphere are described below.

## **Market Access**

The US mutual fund industry has several priorities in the Hemisphere. The first is removing the portfolio investment barriers imposed in several countries that adversely affect the ability of US mutual funds to invest in those countries. For example, a foreign investment company can invest in Brazil only through one of several specialized vehicles each of which requires the prior approval of, and registration with, both the Brazilian Securities Commission and the Central Bank. A similar system exists in Chile which, in addition, imposes repatriation restrictions and requirements to appoint a local administrator for the

investor. Complying with the various restrictions imposed in these countries is time-consuming, administratively difficult and expensive.

These types of investment restrictions are designed to make it more difficult for US mutual funds to invest in these markets. Investments by US mutual funds, however, represent a benign source of capital to developing markets. Mutual funds do not invest for control and funds and their shareholders take a long-term view of their investments in emerging markets.[4](#)

The second priority is to obtain the ability for US firms to manage assets under new pension systems in the Hemisphere. New pension systems funded through individual accounts have been put in place in Chile, Argentina, Columbia, Peru and Uruguay and are now being implemented in Mexico and Bolivia. Similar systems are being considered in Brazil, El Salvador, Costa Rica, Honduras, Nicaragua and Ecuador. US firms seek to participate on the same basis as local firms in organizing pension management entities under these new systems and in marketing mutual fund products as funding vehicles for pension assets in the system.

The third priority for the US asset management industry is to obtain the ability to enter the domestic mutual fund markets of countries in the Hemisphere by establishing wholly-owned affiliates or subsidiaries in the country to sponsor and advise domestic mutual funds for sale to domestic investors and to provide asset management services to other clients in the country. Institute members seeking to do business in the Hemisphere, of course, are willing to submit to local jurisdiction and regulation. We would urge, however, that the requirements for foreign money management firms seeking to provide asset management services in the Hemisphere take into account the unique nature of the money management business. Rules requiring money management affiliates to have large amounts of capital or staff personnel in the country will operate to deny market access to foreign firms.

In distinct contrast to the business of a broker-dealer or bank, creating and managing mutual funds is not a capital intensive business. The assets of a mutual fund are owned by the fund, segregated from the sponsor's assets and held in safekeeping by custodians (e.g. banks) meeting specified requirements. Fund assets thus are safeguarded for the benefit of shareholders and are not at risk if the mutual fund sponsor experiences financial reverses. Similarly, the business of managing pension accounts does not require large amounts of capital.

Requirements specifying the number of advisory personnel that must be based in the country or limiting the ability of employees to serve other clients also operate as barriers to entry. Money managers increasingly serve a global marketplace and have a legitimate business need to serve their world-wide clients efficiently and effectively. US-based firms are unwilling to dedicate their most senior personnel to countries with restrictive staffing rules. Thus, not only do these rules create barriers to entry, they prevent local investors from obtaining the services of a money manager's most experienced employees.

Money management firms also should be allowed to provide asset management services to a variety of clients, including mutual funds, pension plans, other institutions, and wealthy individuals. The regulatory system should permit a single firm to be licensed to provide both mutual fund and other investment management services.

Finally, regulatory systems that require that mutual fund and pension assets be invested exclusively or almost exclusively in domestic securities also operate as barriers to entry for

US firms. Under NAFTA, US money management firms were granted the right to establish wholly-owned Mexican mutual fund operating companies to organize, sponsor and advise Mexican mutual funds. Mexican mutual funds, however, have not been given permission to invest their assets in non-Mexican securities. This prohibition on foreign securities investments is one of the reasons no US firms have yet sought to establish Mexican mutual fund operating companies. The various types of "foreign content" restrictions found in the Hemisphere are not necessary for investor protection. Indeed, they operate to deny citizens the opportunity to obtain asset diversification and the possibility of higher returns through investing in other markets.

#### Regulatory Transparency and Fairness

The FTAA negotiations also should focus on the need for transparent regulations and licensing requirements, and administrative practices that afford a regulated industry the opportunity to comment on matters affecting the industry. It is particularly important that the regulatory system not limit the number of foreign firms that can participate in a country's asset management market or grant regulators the discretion to exercise subjective judgments in granting licenses.

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We appreciate the opportunity to provide the views of the Institute on the issues that should be addressed in the FTAA negotiations. We would be pleased to provide additional information about our comments at the request of the Trade Policy Staff Committee.

Sincerely,

Mary S. Podesta  
Associate Counsel - International

#### ENDNOTES

1 The Investment Company Institute is the national association of the American investment company industry. Its membership includes 6,266 open-end investment companies ("mutual funds"), 443 closed-end investment companies, and 10 sponsors of unit investment trusts. Its mutual fund members have assets of about \$3.627 trillion, accounting for approximately 95% of total industry assets, and have over 59 million individual shareholders.

2 See, for example, Unibanco, SEC No-Action Letter (avail. July 28, 1992); Investment Funds Institute of Canada, SEC No-Action Letter (avail. March 4, 1996).

3 We estimate that the total value of investment company assets in the US managed by foreign investment advisers is \$228 billion as of January 31, 1997, or 5.9% of total industry assets. This figure was approximately \$70 billion, or 3.3% of total industry assets in September 1994.

4 See, "US Mutual Funds: Hot Money or Stable Source of Investment Capital?," Perspective, December 1996. This Institute research report, which examined the behavior of shareholders and portfolio managers of US emerging market funds during the 1990s, found that shareholders did not redeem shares in large volumes during periods of market weakness and portfolio managers did not shift investments between countries in a manner that would exacerbate price swings. Instead, funds frequently bought shares when securities prices were falling and sold in rising markets.

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