

## COMMENT LETTER

April 19, 1997

# Comment Letter with USTR on Trade Issues, April 1997

April 17, 1997

Mr. Peter Collins  
Deputy Assistant US Trade Representative for Services and Investment  
Office of the United States Trade Representative  
Room 301  
600 17th Street  
Washington, DC 20548

Dear Mr. Collins:

The Investment Company Institute appreciates the opportunity to comment on the commitments the US should seek from trading partners in connection with the WTO financial services negotiations that began on April 10, 1997. The Institute<sup>1</sup> is the national association of the US investment company industry. Its members provide asset management services to mutual funds and other investment companies, pension plans and individual clients.

The Institute urges US trade negotiators to seek commitments from trading partners to open their asset management markets. For the reasons discussed below, we believe that countries that open their asset management markets to competition from foreign firms, and provide non-discrimination and national treatment to all participants, can obtain significant economic benefits.

## Background

Investment management is now a global business. Mutual funds increasingly are the investment of choice for middle income individuals saving for a variety of long-term financial goals. Total world mutual fund assets have grown from \$2.4 trillion at the end of 1990 to \$5.3 trillion at the end of 1995. Of this amount, approximately \$3.6 trillion represents assets of US mutual funds.

The worldwide demand for advisory services is expected to grow as the number of middle class investors increases and the need for increased retirement savings by the post World War II baby boom generation gains greater recognition. In addition, investors are expected to continue to want to invest a portion of their assets outside the countries in which they reside. For example, total US mutual fund assets held in international or global funds are

now \$334 billion, or 9% of total US mutual fund assets and 12% of total US long-term mutual fund assets. Of this amount, approximately \$44 billion is held in funds dedicated to investing in emerging markets.

Open markets for investment management services provide important benefits to countries in facilitating capital growth, promoting domestic savings and meeting retirement needs. Open markets improve the opportunity for investors to obtain diversification and an adequate return on their assets. In addition, investment by foreign mutual funds provides a stable source of capital to developing markets. Recently the Institute published a research paper that examines the behavior of shareholders and portfolio managers of US emerging market funds during the 1990s. The paper found that shareholders and portfolio managers did not engage in behavior that would exacerbate price volatility in those markets. See "US Emerging Market Funds: Hot Money or Stable Source of Investment Capital?" Investment Company Institute Perspective, December 1996, a copy of which is attached.

The US market for investment management services is open. Foreign firms receive unconditional national treatment and can register on a non-resident basis. Foreign firms have entered the US market by acquiring US firms, establishing affiliates in the US, or registering as non-resident investment advisers.<sup>2</sup> US firms would like to obtain similar access abroad.

## **Commitments to be Sought in Asset Management**

The Institute urges the US government to seek commitments from its trading partners in the 1997 financial services negotiations to open their asset management markets to:

### **1. Allow foreign firms to establish wholly-owned affiliates to advise and distribute domestic mutual funds and provide asset management services to non-mutual fund clients.**

An open mutual fund market will provide a country with a stronger, more effective market to serve as an engine for capital growth and meet investor needs. Institute members oppose rules that restrict foreign asset management firms to owning only a small percentage of a local affiliate. These rules transfer technology and expertise to local participants while unfairly denying foreign owners a meaningful role in the business. Moreover, long-term success in the asset management industry can be achieved only if investors maintain confidence in the industry's commitment to high ethical standards. A US firm with a minority participation in a foreign asset management enterprise is in a much less favorable position to protect its reputation than it would be if it had a controlling interest in the enterprise.

Trading partners should be asked to commit to eliminate barriers that prevent foreign firms from establishing wholly-owned affiliates. In the case of emerging markets with little industry development, consideration could be given to transition periods for attaining 100% foreign ownership. However, any transition period should be based on a specific timetable.

### **2. Allow foreign institutional investors to invest freely in the securities markets of the country.**

US mutual funds have a substantial interest in investing in foreign securities markets and their investments provide a stable source of capital to developing markets. There are two types of barriers, however, that restrict the ability of US mutual funds to invest in many foreign markets. Many countries impose aggregate limits on foreign investment. Other

countries impose onerous repatriation restrictions, taxes, or cumbersome and costly licensing requirements for foreign institutional investors.

Trading partners should be asked to make commitments to eliminate rules imposing aggregate limits on foreign investment, local/foreign share distinctions, repatriation restrictions and onerous licensing and tax regimes.

### **3. Allow foreign firms to compete with domestic providers for access in managing pension assets.**

Worldwide retirement savings needs can best be met by allowing cross-border competition in managing pension assets. Laws that preclude foreign firms from managing private or public pension assets or impose strict asset allocation requirements and prohibitions on foreign investment operate as barriers to entry for foreign firms. These restrictions also have an adverse effect on pension performance in the countries that impose them.

Trading partners should be asked to make commitments to provide national treatment for foreign firms in managing all pension assets and to eliminate asset allocation and foreign content restrictions and replace them with fiduciary standards based on prudence and diversification.

### **4. Assure that financial services regulations are effective in assuring investor protection and open and fair competition among financial services providers.**

Institute members support strong, effective, transparent regulation that promotes investor confidence by maintaining high industry standards of practice and ethics. A system that permits competition and innovation promotes domestic savings and allows the industry to grow and meet investor needs.

Institute members oppose regulations designed to protect local firms from competition. Prudential requirements should be appropriate for the investment management business and promote competition. Rules requiring large amounts of capital or personnel resident in the country, or requiring separate entities and staff to sponsor and advise mutual funds and provide investment management services to pension plans, deny local investors the services of a foreign money manager's most experienced personnel. Unlike the business of a bank or broker-dealer, the business of managing mutual funds or pension assets does not require large amounts of capital to protect investors.

We urge the US to seek commitments from trading partners to eliminate rules that create barriers to entry. These include rules imposing capital and staffing requirements not needed for investor protection. They also include legal and administrative practices that are non-transparent, limit the number of licenses that can be granted to foreign firms or rely on subjective standards in granting licenses.

### **5. Improve securities market clearance and settlement systems to reduce risks for all investors in the market.**

Deep, liquid and efficient securities markets are critical to meeting the capital needs of the world's developing economies and to sustaining worldwide economic growth. Financial markets with inefficient clearance and settlement systems will be less attractive to portfolio investment by US and other mutual funds than markets that improve their systems by immobilizing securities, providing for the simultaneous transfer of title and good funds, and assuring effective fail procedures and regulation of market participants.

The US mutual fund industry has worked with other mutual fund industries around the world to identify the preferred clearance and settlement practices that will make securities markets more attractive to mutual fund investment. Improving clearance and settlement systems will benefit all participants in a market, not just foreign institutional investors. Trading partners should be encouraged to make these improvements.

\* \* \*

The Institute appreciates the opportunity to provide its views on the issues that should be addressed in the 1997 WTO financial services negotiations. We would be happy to provide additional information on any of the matters discussed in this letter.

Sincerely,

Mary S. Podesta  
Associate Counsel - International

cc: Matthew Hennesy  
Director, Office of Financial Services Negotiation  
US Department of the Treasury

#### **ENDNOTES**

1 The Institute's 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 US industry assets, and have over 59 million individual shareholders.

2 We estimate that the total value of mutual fund assets in the US managed by foreign investment advisers as of January 31, 1997 is approximately \$215 billion, or 5.9% of mutual fund assets. This compares to \$136 billion, or 4.8%, at the beginning of 1996 and \$70 billion, or 3.3% as of September 1994.