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News Release

ICI Conference
Europe: A Mutual Fund Marketing Roadmap

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Good afternoon. I'm happy to have the opportunity to speak to you today. As Gisbert Wolff promised, I must first state that I speak only for myself, and my views are not necessarily shared by the Commission, its members or other SEC staffers. Nevertheless, I can say without any equivocation that the internationalization of the securities markets is a major concern of the Commission and its staff. As SEC Chairman Breeden said during his recent visit to Japan, the ultimate goal of the world's major markets should be to promote simultaneous access by issuers and investors to the world's capital markets, and increasing the free flow of capital across international boundaries will, in the long run, promote worldwide economic growth and prosperity.

During the past ten years in the United States, mutual funds and other pooled investment vehicles have experienced enormous growth and popularity. Increasingly, mutual funds are the means that average Americans use to invest in the securities markets, not just in the U.S., but in foreign securities markets as well. This same trend is occurring in many other parts of the world, particularly Europe. As a result, the mutual fund industry, both here and abroad, has been and must continue to be a key consideration in our efforts to promote efficient, fair and open international securities markets.

According to the program, I'm supposed to talk about the outlook for EC-US reciprocity. I guess the idea was that I would listen to what the other speakers had to say over the last two days, and then put all that information into my crystal ball and come up with a prediction. The trouble is, what with one thing and another at the office, I missed a lot of the program and am going to have to catch up by listening to the audio tapes. Also, I understand, from representatives of our State, Commerce and Treasury Departments, that United States' policy is to seek "national treatment", not reciprocity. That is, we'll let foreign firms do business in the U.S. on the same terms and conditions that apply to U.S. persons, and we look for the same treatment abroad.

However, I think it would be a good idea if United States' foreign policymakers would give some thought to the point Gisbert Wolff made to this group yesterday. He and I have talked about it before. Mr. Wolff pointed out that the European Community determined that "national treatment" was not a very good way to provide free and open access to the financial markets across national borders, because it is often hard, if not impossible, for a firm to comply with requirements in its own country and also those in other countries. Too often, these requirements are inconsistent: the same firm can't meet two or more regulatory requirements at the same time. As a result, national treatment policies frequently work only if a firm sets up separate entities to do business in separate countries, and that's expensive and counterproductive if your goal is a "common market" and open access.

So, the European Community has moved toward the policy of "mutual recognition" that is reflected in the UCITS Directive. Under this policy, members of the Community have agreed to accept and rely on each other's regulations <u>and</u> <u>regulators</u>, to protect investors. On this basis, UCITS can be sold to the investing public throughout the Community.

My personal view is that the EC may be right: the concept of national treatment may not work in practice as a means of opening up cross-border access in the financial services area, at least not so long as individual countries have conflicting and inconsistent systems of business organization and regulation. I am hopeful, therefore, that the United States will at least consider the concept. We could call it "mutual recognition", and avoid that dirty word "reciprocity".

On the other hand, whether the EC policy of "mutual recognition", as embodied in the UCITS Directive, will work well in practice also remains to be seen. And before we go too far toward encouraging our foreign policymakers to consider the concept, we need to think about the practical problems.

Even within the European Community, we have yet to see whether the UCITS Directive will really provide wide-open access to markets throughout the Community. The UCITS Directive requires, as a pre-condition, that each member country bring its own regulatory requirements up to certain specified minimum standards. But member states are free to impose tougher requirements on their own UCITS, and some have done so. Query whether the costs incurred by firms from those countries with above-the-minimum standards will place them at a competitive disadvantage in marketing their products and services, both at home and elsewhere in the Community. Mr. Wolff's answer is that there may be a compensating public confidence factor that will outweigh or at least balance those costs. The idea is that investors will choose UCITS from tougher regulation countries over competing, lower cost UCITS from minimum standard countries, for safety's sake. I'm not sure about that -- it may take a major scandal and large investor losses to produce that result, something nobody wants to see.

The Directive also left marketing or sales practice regulation to each individual country where a UCITS, regardless of its country of origin, is being sold. This is an aspect of the investment company business that we all know is difficult to police even within our own borders and can't be effectively enforced just by regulating the investment company and its manager. You have to be able to reach those doing the selling.

The Directive forbids use of marketing regulation to discriminate against UCITS from other member states, but this may be difficult to police. You can have no discrimination as a matter of law only to find that, in practice, a foreign firm has a devil of a time complying with marketing requirements. An example of this may be a requirement that UCITS be sold only through banks or licensed broker-dealers, who all have their own competing pooled investment products to peddle. It may be impossible for a foreign competitor to get "shelf space".

The Directive also avoided some difficult questions by limiting its coverage to those pooled vehicles that are the rough equivalent of a U.S. mutual fund that invests in exchange-listed or NASDAQ securities, thus avoiding "merit regulation" worries about the higher risk or exotic investment company products that are available in the U.S. and other countries. An attempt was also made to exclude money market funds, in light of the concerns of some central bankers who see money funds as a major cause of the troubles U.S. banks and savings and loans face today. These restrictions are going to limit the ability of firms to compete on the basis of new products that don't qualify as UCITS. UCITS are plain vanilla mutual funds, and most EC member countries already have plenty of their own available.

And last but certainly not least, the Directive side-stepped the question of the different tax treatment given to UCITS throughout the EC, leaving it entirely up to each country to decide how to tax its own citizens on the earnings and gains of pooled investment vehicles, including UCITS, and apparently leaving each EC member country free to discriminate through its tax laws against UCITS from other EC member states -- assuming they enforce their tax laws and collect the tax owed!

. It will be interesting to see, over the next few years, how much cross-border business UCITS are able to do, given these limitations and practical problems.

U.S. business leaders and government policymakers will have to balance similar issues in determining whether "mutual recognition" is a goal we should pursue. Will our different regulatory system for mutual funds -- Securities Act registration of shares; our prospectus delivery requirements, both at the Federal and state level, Securities Exchange Act reporting and proxy voting; our corporate governance system, which relies on directors to serve as watchdogs for investor interests; shareholder voting requirements; our tax requirements, and the detailed regulatory requirements we impose under both the Investment Company Act and the Investment Advisers Act on mutual funds and their managers -- will these place our funds at such a competitive disadvantage that "mutual recognition" would, in practice, become a one-way street or, worse, drive our money management industry off-shore? If so, can we streamline our

State and Federal regulatory requirements and eliminate unfavorable tax treatment, at least as to foreign fund shareholders, in a way that is consistent with our own concepts of investor protection and without a major adverse impact on our tax revenues?

These are issues I can't answer, but they certainly merit the time and attention of business leaders and our government.

What I can do is to let you know how I feel about the regulatory differences that must be addressed. My attitude has changed dramatically over the past 5 years. This is because I've gotten to know many of the people who regulate mutual funds in Europe. I've listened to them and learned what they do. This listening cured me of the notion that the U.S. regulatory system is the only good one around and that nobody in the world can hold a candle to the SEC and other U.S. regulators.

Each year, I attend a meeting of the Enlarged Contact Group for the Supervision of Investment Funds. This is an annual meeting of mutual fund regulators from the European Community, and several countries that don't belong to the Community like Switzerland, Sweden, Canada and Japan. These meetings were started after the IOS scandal as a way of establishing and maintaining informal contacts and providing mutual assistance among those of us responsible for protecting mutual fund investors around the world. We give each other updates on industry and regulatory developments in our respective jurisdictions, raise problems or concerns that we have, and get the benefit of learning how these have been handled by our colleagues in other countries or how they would suggest that the matters be handled. Gisbert Wolff, yesterday's lunch speaker, is a frequent participant.

For the past few years, much of the discussion at our meetings have focused on the content, interpretation and implementation of the UCITS Directive.

I've come to believe that the UCITS Directive provides a model that we and other countries throughout the world can look to as we seek ways to open the international securities markets to free and fair competition, without sacrificing the important goal of maintaining investor protection.

The UCITS Directive creates opportunities for the U.S. investment company industry. First, if a money manager can set up a fund in a member country and qualify as a UCITS, the entire European Community is available as a market -- all twelve countries, not just one. The Directive also opens up the possibility that the U.S. can negotiate a treaty with the European Community as a whole, to provide for mutual recognition of each other's regulatory systems, at least for certain classes of investment companies, that would permit sales back and forth across the Atlantic. For the past few years, the European Federation of Investment Funds and Companies has been meeting twice a year and talking about this very thing with the Investment Company Institute.

There are problems to be overcome. Perhaps the most significant obstacle that would make it difficult to sell U.S. funds in Europe are U.S. tax requirements -- the required distribution of fund earnings to shareholders, the withholding tax and the estate tax that can be imposed on a foreigner who dies while owning shares in a U.S. mutual fund.

I hope that the SEC will not be an obstacle. There are some major differences, of course, between the U.S. regulatory system for mutual funds and the minimum standards required by the UCITS Directive, that will need to be resolved. One is the EC's requirement that the manager of a UCITS have sufficient financial resources to conduct its business effectively and meet its liabilities. To authorize a UCITS, regulators in its home country also have to "approve" the management company, the fund's rules, including its instruments of incorporation, and its choice of a depository for fund assets. The Directive expressly provides that approval shall not be given "if the directors of the management company, the investment company or the depository are not of sufficiently good repute or lack the experience required for the performance of their duties."

Our system, in contrast, allows virtually anyone who can come up with $150 to register as an investment adviser and then, if they can come up with an additional $100,000 in seed money, they may start a mutual fund, provided they don't have a history of adjudicated securities law violations. Of course, under the U.S. regulatory scheme, investment company directors, particularly the independent directors, play a significant role in safeguarding the interests of investors in areas where the UCITS Directive consigns responsibility to regulators.

Other significant differences are that forward pricing is not required of a UCITS, and there don't appear to be express prohibitions against self-dealing comparable to our Section 17 -- which, as you know, outlaws practically everything unless the SEC, by rule or order, says O.K. And they don't have fee table or yield calculation requirements -- yet. But I can report a great deal of interest on the part of the Europeans in getting copies of our fee table and advertising rules.

I know that Chairman Breeden is very interested in taking steps to further the ability of our investment company and investment management industry to market its products and services throughout the world. And I, as one member of the SEC's staff and speaking only for myself, can tell you that my yearly meetings with my counterparts from the European Community have convinced me of this: Sure, there are differences between our regulations and those in Europe. There are differences in the ways our funds are structured and governed. In a few respects, our requirements are stricter, but in as many situations the regulations in Europe are tougher and perhaps more protective of investors that what we require. But throughout the European Community, the system of regulation for UCITS is pretty good, and the regulators are a savvy group of people who very much have investor protection in mind. I think the differences between our regulatory systems can be worked out, with a little give and take on both sides.

As a legal matter, I think a treaty, confirmed by the U.S. Senate, would nicely take care of Section 7(d) of the Investment Company Act and Section 6(c) probably gives us all the flexibility we need to work out any other 1940 Act issues. The tax issues, of course, will have to be decided by Congress and the Treasury Department. A treaty between the U.S. and the EC may be preferable to broader legislation as a means of allowing cross-border sales. A treaty would only allow EC member state UCITS to be sold here. It would not open the door to mutual funds from other countries that do not allow U. S. funds equal access or provide adequate protection to fund investors.

What's the likelihood of achieving such a treaty? Well, it depends on a lot of things. First, the mutual fund industry on both sides of the Atlantic has to decide that it would be mutually advantageous -- that both sides could make money. In the case of the U.S., our industry has to be convinced that our government would take steps to remove tax disincentives to foreign investment in U.S. funds, and that the SEC and other regulators here would be willing to work with open minds to resolve, or accept without resolution, regulatory differences. If that happens, I think our government could be persuaded to sit down at the bargaining table with the EC. On the EC side, Mr. Wolff says all member states would have to indicate some willingness to pursue a treaty, since it would not be worthwhile for the EC to use its very limited and overworked staff resources to pursue a treaty that, in the end, one or more member states would veto. On the U.S. side, our different government agencies with jurisdiction over the matter --State, Treasury, Commerce, the SEC and state regulators -- would have to work together on the matter. Not an easy task, as all these agencies are short-handed, have too much to do, and staff turnover makes any long-term project difficult, since our government does not see fit to pay civil servants a competitive wage.

We should move on two tracks. First, efforts to explore the possibility of a mutual recognition treaty with the entire European Community should continue. Second, we need to seriously reexamine our own regulatory system and mutual fund governance structure to see if it should be revamped to bring it more in line with the way collective investment vehicles are operated in the rest of the world. If the costs of our system are too high, keeping it in place may ultimately drive the money management business offshore.

We also need to find out from European Community staff and member state regulators those areas in which they believe our regulations may fall short, and see if we can take steps to tighten up our requirements, at least as to those funds we would hope to qualify for sale in Europe. In this area, I think the "vetting" or regulatory approval of fund managers' financial capacity, experience and training and "good repute" is likely to be an important issue. The IOS debacle has not been forgotten in Europe, nor have they forgotten that the chief culprits were Americans. The EC has taken a conservative approach in the UCITS Directive. They don't want the reciprocity afforded by the Directive to lead to investor losses, and they certainly don't want to risk importing potential problems from the U.S. I think we can convince them that this won't happen.

We are not the only ones interested in access to the EC. We will have competition just getting to the negotiating table. But if the business communities on both sides of the Atlantic see mutual benefits to cross-border sales, I am confident that U.S. regulators will not prove to be immovable obstacles.

In closing, I want you all to know that I am delighted that the ICI has taken the initiative and is pursuing opening up the international markets. The SEC wants to be a help, not a hindrance.

Thank you for your attention.

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