REMARKS OF

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GLOBALIZATION OF MUTUAL FUNDS

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* The views expressed herein are those of Commissioner Beese and do not necessarily represent those of the Commission, other Commissioners, or the staff.

U.S. Securities and Exchange Commission
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Bermuda

Distinguished guests, ladies and gentlemen. It's a pleasure to be here, and of course, it's always a pleasure to come to Bermuda.

At this moment, two thousand miles away in America's heartland, a worker in Peoria, Illinois uses his 401K plan to invest in a diversified mutual fund holding shares in a wide variety of european companies. Why? Because someday, when he retires, he hopes to continue to enjoy the fruits of his labors. Someday, he hopes for the good life, perhaps spending part of it right here, under the sun-kissed skies of Bermuda.

For more than a century now, investment companies have been helping Americans fulfill their dreams, either directly by providing exceptional investment opportunities, or indirectly, by providing much-needed capital to help finance a growing and expanding economy.

In fact, part of America's economic success can be traced to the global nature of the early mutual fund industry. The first investment companies came to America from across the Atlantic. During the late 1800's, after the U.S. Civil War, English and Scottish investment trusts established themselves in Boston, Philadelphia, and New York. Despite the ravages of war, many Europeans saw enormous potential in the young United States.

Investment trusts opened the way for Europeans to prosper by investing in the rebirth and expansion of America. Investment trusts provided the capital that built the railroads. They provided the financing that made it possible for pioneers to farm the frontier. Later, investment companies would help raise the money to construct factories that mass produced products -- ushering in a new era of industrialization.

Europeans, using the equivalent of today's mutual funds, saw an opportunity to prosper by investing in the growth and development of the United States. Today, investors world-wide see the very same opportunities in every continent. From Latin America, to Eastern Europe, to Southeast Asia, nations are rebuilding their economies by opening markets, privatizing state-run companies and encouraging entrepreneurship. And, just as it was more than a century ago, investment companies provide a fitting investment vehicle to allow people to share in the prosperity fostered by innovative companies and promising countries.

As the global economy continues to grow, so too will its hunger for capital -- creating even more international investment opportunities, and more potential international customers, for investment companies around the world.

The question you are grappling with at this conference, and that we, as regulators, grapple with every day, is how best to facilitate the flow of capital to these investment companies, and still maintain investor confidence by providing the levels of protection that fund investors have come to expect.

This is a difficult and important question, and it deserves our attention. In fact, this past February I met with regulators representing twenty-two countries from around the world who form the Technical Committee of the International Organization of Securities Commissioners, better known as "IOSCO". A working party was formed to discuss this very issue, in hopes of identifying common ground among the different rules and regulations that govern the global mutual fund industry. We agreed that we needed to move forward with this type of effort.

And for good reason. Increasingly, investors, particularly Americans, are looking to foreign companies and foreign markets in search of greater returns. Foreign companies from all over the world raised more than $66 billion in capital in U.S. public and private markets in 1992, compared with $48 billion in 1991 and $34 billion in 1990. And last year, total U.S. investor transactions in foreign equities reached a record high of $270.9 billion.

This increased interest in foreign equities shows few signs of abatement, and is having a global impact. American investors now trade $1.1 trillion in foreign equity markets. That's 11% of all equity trading worldwide.

Certainly, the growing American appetite for investments with a foreign flavor is one reason fueling the heightened interest in the globalization of the mutual fund industry. And considering the dramatic success and growth of the U.S. domestic mutual fund market, it's easy to see why so many market participants are looking to Congress and the Securities and Exchange Commission to pave the way for further expansion of this industry world-wide.

And why not? After all, breaking down the barriers that impede cross-border sales of investment company shares seems to be an attractive proposition. Investors would receive greater access to a wider array of investment opportunities, especially those focused on potentially high growth emerging markets. Fund managers and investment advisers would receive greater access to foreign markets and customers, to further export their money management expertise. And finally, portions of the global financial markets would receive greater access to additional capital, making them deeper, more liquid and more efficient.

But, as they say in the states, there is no such thing as a free lunch. Global expansion of the investment company industry through international competition has incredible upside potential, but at what cost? Ironically, though technology has made it easier to invest on a global basis, regulation has perhaps made it more difficult. True free trade for the mutual fund industry -- where domestic and foreign funds can compete on a somewhat level playing field at home or abroad -- can only be achieved in an environment of regulatory cooperation. Certainly, no country will freely relinquish vital investor protections or valuable competitive advantages without receiving something in return.

This need for some sort of quid pro quo has effectively left part of the burden of the global expansion of investment companies in the hands of the off-shore industry. And for an industry born out of regulatory wedlock, a bastard child of complex tax codes and restrictive securities laws, the growth of the off-shore funds has certainly been quite impressive. With the recent developments in the E.C. marketplace, off-shore funds are not only located in Bermuda, the Netherlands Antilles and Luxembourg, but are also now rapidly proliferating in places such as Dublin and Brussels. And hub and spoke structures with off-shore spokes may foreshadow even greater growth in the future.

Still, the amount of assets held by these off-shore funds is dwarfed by the domestic fund industry in most countries. And while off-shore funds have played an essential and valuable role in promoting the flow of capital throughout the international economy, rapid globalalization of the mutual fund industry will only be realized when the regulatory barriers preventing international competition are effectively minimized or eliminated.

The question then becomes how best to achieve this ambitious goal.

Unfortunately, due to the many differing regulatory schemes present in the international marketplace, there is no easy solution. In simple terms, reciprocity is the key.

For the U.S., reciprocity means that we must address the barriers to entry section 7(d) of the Investment Company Act presents to foreign funds. Here's an interesting story: as originally proposed, the Investment Company Act absolutely prohibited foreign funds from selling shares in the U.S. As history has it, this language, of course, remained on the cutting room floor when the last all-night session ended and the Act was presented for Congressional approval.

The SEC has always had the power to issue 7(d) orders to allow foreign funds to register and sell shares. But the problem has been making sure that those obtaining orders had sufficient safeguards in place to protect the interests of U.S. investors. Since this problem has yet to be solved, today, as you well know, section 7(d) essentially prevents foreign funds from selling shares in the U.S., unless they operate as a U.S. investment company. In fact, the last 7(d) order was issued almost 20 years ago.

On the other hand, for other countries, reciprocity means finding ways to facilitate open and competitive markets, so that U.S. fund managers have more than an empty promise to enter the market, but also have a fighting chance to effectively market and distribute their shares abroad.

Earlier this year, the SEC demonstrated its willingness to open up American markets somewhat by making it easier for foreign investment advisers to offer their services to U.S. clients. Under the old standards, if a U.S. registered foreign investment adviser shared common employees with its parent company, the parent would also have to register and subject itself to U.S. law. This was true even if the non-registered parent only serviced non-U.S. clients. Additionally, if a U.S. registered foreign adviser offered advice to both U.S. and non-U.S. clients, it had to comply with U.S. law, even with regard to the advice given to its non-U.S. clients. These factors created a huge incentive for foreign investment advisers to keep their best personnel at home, or perhaps not even offer advice to U.S. clients.

But now things are changing. Last July, the SEC took a significant step when it approved the Unibanco no-action letter[1], which narrowed the application of the Advisers Act to foreign investment advisers. As a result, a U.S. registered foreign adviser may now render advice to non-U.S. clients pursuant to their home country's laws, without any need to comply with U.S. law. Moreover, foreign investment advisers have much greater flexibility in forming U.S. subsidiaries, and staffing them with their best and brightest local talent. Of course, to protect U.S. investors, foreign advisers and their affiliates involved in advising U.S. clients will have to maintain certain trading and other records for SEC inspection, and make their personnel available for testimony in SEC investigations, but customer identities would not have to be revealed.

Since the Unibanco interpretive no-letter was issued, the SEC staff has issued two more no-action letters and more are expected. This effort should greatly facilitate the ability of foreign investment advisers to conduct their business on a global basis. In fact, later this afternoon there is a panel discussion providing details on exactly what we did.

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1 Uniano de Bancos de Brasileiros S.A. (pub. avail. July 28, 1992).

But foreign investment advisers aren't the only winners as a result of our action. U.S. investors also won because they now will have greater access to the very best foreign investment advice. Still, despite these obvious benefits, the final decision could only be made after a framework had been established to guarantee that the interests of U.S. investors would still be adequately protected.

While the regulatory climate in the U.S. is now more conducive to foreign investment advisers, the fact remains that seeking legislation to amend section 7(d) of the Investment Company Act is still a necessary step if foreign funds are to have broad access to American markets. Certainly, SEC could ask Congress to amend section 7(d) to provide for more flexibility than is currently available. But practically speaking, obtaining congressional approval for any legislation will depend ultimately on the willingness of foreign regulators to open up their markets.

Only two years ago the U.S. Senate passed a bill authorizing the SEC to deny investment adviser registration to a foreign company if the company's home country denied U.S. investment advisers national treatment. A committee of the U.S. House of Representatives considered similar legislation. Although neither bill became law, my sense is that Congress will still want U.S. funds to have real access to foreign markets if foreign funds are to have unfettered access to U.S. markets.

As of now, it remains to be seen how many countries would be willing to provide the necessary degree of access needed to placate Congress. And given the current posturing involved in trade talks, it hard to see why Congress would treat shares of foreign investment companies any differently than they treat foreign computer chips or imported wine.

Equally important, it also remains to be seen how many fund managers will want to sell shares in the U.S. absent some change in the U.S. tax laws. I am encouraged by the limited success of the German tax treaty, which shows there are ways to minimize host country tax burdens. Still, given the current fiscal environment in Washington, tax code changes will be hard to come by, especially those for foreign entities.

Of course, resolving these issues is just the first part of the puzzle. The eventual success of any amendment to section 7(d) or the tax laws will also depend on whether foreign regulatory schemes can meet the investor protection safeguards that are sure to be included in any legislation. The SEC will play the primary role in making this determination. So until a majority of the members of the SEC can be satisfied that U.S. investors purchasing shares of foreign funds will be adequately protected, there is little likelihood that any proposed amendment to section 7(d) will have any real effect.

Clearly, at some point, the U.S. and those countries wishing to sell their domestic funds abroad will have to sit down and hammer out their differences over the appropriate levels for investor protection. I am optimistic that there is room to negotiate reciprocal agreements among these various countries, provided each nation or trading group can appreciate and understand just how far their counterparts can move during negotiations.

The European Community's UCITS directive[2] has provided a firm foundation for these types of negotiated agreements. By allowing a fund that meets its home country's laws to be cross-marketed within the European Community, the UCITS directive eliminates the primary barrier to cross-border fund sales. Moreover, some measure of flexibility is included by providing that other member countries can require compliance with their domestic marketing rules, as long as these rules are non-discriminatory. Of course, the UCITS directive works only because the members of the European Community has been able to establish a mutually agreeable minimum standard for investor protection.

Building on the foundation laid by the UCITS directive, representatives of the US and European mutual fund industry have made great strides in the search for common ground between their respective regulatory schemes. Still, finding a mutually agreeable minimum standard for investor protection remains problematic. The primary stumbling block is the regulatory treatment of affiliated party transactions, although there are others concerns over custodial matters, pricing and the role of independent directors.

Whereas the US has strict guidelines governing affiliated party transactions, the European way of doing business provides far greater latitude. And even beyond the investor protection issue, others have questioned whether allowing certain affiliated transactions may provide European funds with a competitive advantage vis a vis their U. S. counterparts. Until these issues can be resolved, it is unlikely that any final accord can be reached.

For those of you who question why U.S. regulators are so intent on maintaining strict control over affiliated party

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[2] The European Community directive, effective October 1, 1989, relating to "undertakings for collective investment in transferable securities," is commonly referred to as the UCITS directive.

transactions, let me place this issue in context. On its face, a related party transaction appears to be one primarily concerning fiduciary obligations and the need for appropriate disclosure. But aside from these conflict of interest concerns, it's important to realize what mutual funds have become in America.

For many U.S. investors, mutual funds are much more than an ancillary investment in their portfolio. Increasingly, Americans are depending on mutual funds to provide their checking accounts and credit cards, to protect and grow their savings, to pay for their kid's college tuition, and to provide for an adequate standard of living at retirement. Mutual funds have become so intertwined with the U.S. financial system that their regulation raises issues of financial safety and soundness. So from a regulatory standpoint, the issue of affiliated transactions involves more than just protecting individual investors. It also involves protecting America's financial peace of mind.

U.S. investors have reached a comfort level with their mutual funds. Perhaps the trust Americans place in their mutual funds is the U.S. industry's greatest resource. Fund managers around the world should keep this in mind when contemplating regulatory changes that may jeopardize this most important asset. For an industry whose members are young enough to remember the dark days following the go-go years of the 60's, and the infamous demise of Investors Overseas Services, common sense says to proceed slowly, lest the quest for new customers alienates old ones.

In closing, it's important to note that over the past 100 years, the globalization of the mutual fund industry has come a long way from those investment company managers who, entrusted with the wealth of their clients, came by ship to the shores of America. Technological advancements have shrunk the international financial community into a global village where investors around the world can, with one simple phone call, invest and share in the growth and development of other nations.

With the birth of the new countries in the former Soviet Union, the resurgence of market-driven economies in Eastern Europe the economic vitality of the Pacific Rim, and the global privatization drive that is soaking up capital, it is more critical than ever to eliminate the barriers that are preventing funds from reaching these nations and preventing people from investing in so many promising ventures.

Clearly, as the world grows smaller, the demand for international investments will continue to increase. Capital knows no borders, and like a river that naturally flows to the sea, so too will capital flow to its highest return, as long as no dams exist to temporarily impede its progress. As the recent growth of the off-shore fund industry clearly illustrates, where there is demand, supply is sure to follow.

As a securities regulator, I always hope that I can react responsibly to allow and encourage the marketplace to meet investor demands as quickly and efficiently as possible. In some instances, and this may be one of them, investor demands must rise up to such a level that those in power can no longer ignore the urgent requests for change.

I'm pleased to see so many of you here working towards satisfying the demands of the marketplace. Perhaps, as time passes, your success will further illuminate the need for regulators and legislators around the world to re-assess what regulations are truly necessary to best serve the public interest and to protect investors. And seen in a new light, the globalization of the mutual fund industry can proceed more rapidly on a level playing field, to the benefit of all nations.

I wish you continued good luck in your future endeavors.

Thank you.