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

IVISION OF
MENT MANAGEMENT

November 5, 1997

ACT ICA
SECTION §7(d)
RULE
PUBLIC AVAILABILITY 11-5-97

Mr. Mike Krichew
400 Deming Street
Rochester, NY 14606-3422

Re: U.S. Regulation of Canadian Mutual Funds

Dear Mr. Krichew:

This letter is in response to questions you posed during a telephone conversation on September 11, 1997 with Eileen Smiley and me regarding the involuntary closing of your account by a Canadian brokerage firm. During that telephone conversation, you requested that we send you a letter summarizing the U.S. securities laws governing the sale of securities by Canadian companies to residents of the United States. You also requested that we summarize how you can invest the proceeds from maturing Canadian bonds that you hold in other Canadian investments without violating the U.S. securities laws. In the course of preparing this letter, we also consulted with the Divisions of Corporation Finance (relating to the registration requirements for securities) and Market Regulation (relating to the regulation of broker-dealers).

During the telephone conversation, you stated that your Canadian broker was closing your account because of recent changes to the U.S. securities laws and interpretations of those laws by the Securities and Exchange Commission (the "Commission"). Certain U.S. securities laws, discussed below, can restrict the ability of non-U.S. registered mutual funds and other foreign issuers from publicly offering or selling their shares to persons living in the United States. As we discussed, however, none of these laws has been modified recently, nor has the Commission recently changed its enforcement policies with respect to these laws or any of the rules promulgated under these laws.

As a general proposition, any issuer that publicly offers or sells its securities in the United States is subject to regulation under the U.S. securities laws. Most requirements apply equally to domestic and foreign issuers, irrespective of whether the offerees or purchasers of the issuer's securities are U.S. residents or citizens. The principal U.S. securities laws that impose requirements with respect to the public offer and sale of mutual fund[1] shares are the Securities Act of 1933 ("Securities Act") and the Investment Company Act of 1940 ("Investment Company Act"). In addition, the Securities Exchange Act of 1934 ("Exchange Act") requires brokers that seek to do business with U.S. investors, in either U.S. or foreign securities, to register with the Commission or seek an exemption.

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[1]The term "mutual fund" means an open-end investment company that continously offers its shares to the public and is required to redeem shares at the request of shareholders at the current net asset value.

Securities Act

Under the Securities Act, any issuer that seeks to offer or sell its securities publicly in the United States must register the offer and sale of those securities with the Commission. This registration requirement applies equally to securities issued by either U.S. or foreign companies, including mutual funds.

It is possible for U.S. and foreign companies to sell securities in the United States without registering with the Commission if the sale is conducted as a "private placement." In general, "private placements" can be sold only to "accredited investors," which includes individuals with a net worth over $1,000,000, or individuals with yearly income exceeding $200,000. To qualify as a "private placement," offerings of securities also may not exceed certain aggregate dollar amount limits and/or limits on the number of accredited investors who may purchase the securities. Finally, to qualify as a "private placement," issuers generally may not offer or sell the securities using any form of general solicitation or advertising within the United States.

Section 7(d) under the Investment Company Act

In addition to the requirements of the Securities Act, the Investment Company Act and the Commission's rules thereunder require the registration of mutual funds and contain comprehensive requirements concerning many aspects of a mutual fund's operations. In the case of a mutual fund organized under the laws of another country, Section 7(d) of the Investment Company Act prohibits such a fund from publicly offering or selling its securities in the United States unless the Commission has issued an order permitting the fund to register. To issue an order under Section 7(d), the Commission must find that it is legally and practically feasible to enforce the provisions of the Investment Company Act and that issuing the order is consistent with the public interest and the protection of investors. Rule 7d-1 under the Investment Company Act, adopted by the Commission in 1954, establishes conditions whereby a Canadian mutual fund can be eligible to receive an order permitting it to register under the Investment Company Act. Only three Canadian funds, however, have elected to comply with the conditions in Rule 7d-1 and to apply for a Section 7(d) order.[2]

Section 7(d) does not prohibit a mutual fund from selling shares to U.S. residents who purchase shares in transactions that occur totally outside of the United States. Section 7(d) applies only when a foreign mutual fund utilizes jurisdictional means (e.g., telephone, U.S. mail or other instrumentality of interstate commerce) to offer its securities *publicly* to U.S.

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[2]Those funds are Great West Variable Annuity Account A, Keystone Fund of Canada, and the Scudder Fund of Canada, Ltd.

residents. Consistent with an exemption available to U.S.-based mutual funds,[3] the Division of Investment Management also has traditionally taken the position that a foreign fund is permitted to make private offers and sales of its securities to no more than 100 U.S. residents without violating Section 7(d). Such foreign funds, however, sometimes exceed the 100 U.S. resident limit because of actions solely outside of their control. In 1996, in response to a request from the trade association for Canadian mutual funds, the Division of Investment Management stated that an unregistered foreign mutual fund that privately sold its securities to no more than 100 U.S. residents would not violate Section 7(d) if the number of its U.S. resident shareholders subsequently exceeded that limit based solely on: (1) the relocation of foreign securityholders to the United States; or (2) offshore secondary market transactions not involving the foreign fund or persons acting on its behalf. The Division of Investment Management also clarified that such foreign funds, without violating Section 7(d), could continue to: (1) send shareholder reports, account statements, proxies and other reports required under foreign law; (2) process redemptions and payment of dividends and distributions; (3) process mechanical transfers of ownership; and (4) operate a dividend reinvestment plan.

A foreign fund with U.S. investors, however, generally may not process exchange requests by those investors (i.e., a request by a U.S. resident to sell an interest in one mutual fund and invest all or a portion of the proceeds in another mutual fund), or allow its U.S. resident shareholders to purchase additional securities other than through a dividend reinvestment plan. Both exchanges and additional purchases typically would be considered a public offering of securities and would not be permissible under the Securities Act or the Investment Company Act, absent registration of the securities and the mutual fund with the Commission.

Consistent with a new exemption available to U.S-based mutual funds, the Division of Investment Management recently stated that an unregistered foreign fund may privately offer its shares to an unlimited number of U.S. residents who meet the definition of a "qualified purchaser" contained in Section 2(a)(51) of the Investment Company Act.[4] The term qualified purchaser includes, among others, individuals with $5,000,000 or more in investments.

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[3]Section 3(c)(1) provides an exemption from regulation to any U.S.-based fund that is not conducting a public offering of securities and has 100 or fewer shareholders. A copy of Section 3(c)(1) is attached for your reference.

[4]This exemption is contained in Section 3(c)(7) of the Investment Company Act. Copies of Sections 3(c)(7) and 2(a)(51) also are included.

Section 7(d) does not violate treaties promoting free trade

During the telephone conversation, you stated your belief that Section 7(d) discriminated against foreign funds and was inconsistent with principles of, and treaties governing, free trade between Canada and the United States. Both the North American Free Trade Agreement ("NAFTA") and the General Agreement on Trade in Services ("GATS"), however, include provisions that expressly permit signatories to regulate for "prudential" reasons, including for the protection of investors. These prudential carveouts are contained in Article 1410(1) of NAFTA and Section 2(a) of the Annex on Financial Services to the GATS, copies of which are attached to this letter.

The Investment Company Act was passed to address specific, well-documented abuses that caused U.S. shareholders to incur substantial losses. These losses occurred because investment companies were organized and operated to serve the interests of fund sponsors and managers rather than investors. Section 7(d) is a prudential standard that ensures that U.S. investors receive the same essential protections whether they acquire shares in a public offering of a U.S.-based fund or a non-U.S. fund. The requirements of the Investment Company Act apply equally to foreign and U.S.-based mutual funds, and provide non-discriminatory treatment for non-U.S. funds: any non-U.S. fund that can provide the investor protections required by the Investment Company Act may access the U.S. market through a public offering of its securities. Foreign funds, however, often are structured differently from U.S. funds, and many foreign jurisdictions do not address in a comparable manner the investor protection concerns addressed by the Investment Company Act. Thus, most funds organized outside the United States choose not to apply for an order to register under the Investment Company Act, and thus do not publicly offer their shares in the United States.

Permissible Canadian Investments

You also inquired how you could lawfully invest the proceeds of maturing Canadian bonds in other securities issued by a Canadian company. The Commission's staff is not in a position to give you legal advice on any particular investment. We can, however, provide you with a general description of how the U.S. securities laws operate.

In general, you can purchase securities issued by a Canadian company, without restriction by the U.S. securities laws, any time that you are outside of the United States, provided that the Canadian company does not utilize the U.S. telephone lines, U.S. mail or other instrumentality of interstate commerce to offer the securities.

It is generally possible for persons in the United States to purchase and sell foreign securities in ordinary secondary market transactions on foreign stock exchanges, including the securities of any Canadian company listed on the Toronto, Montreal, Alberta or

Vancouver Stock Exchanges.[5] The transaction, however, would need to be done either through a broker registered with the Commission or one that is exempt from registration. Rule 15a-6 under the Exchange Act provides a limited exemption for foreign brokers that do business with U.S. investors. Although most provisions of Rule 15a-6 apply to transactions by foreign brokers for large U.S. institutional investors such as mutual funds, one provision of the rule may be relevant to you. Rule 15a-6 permits a foreign broker, without registering with the Commission, to conduct a trade for a U.S. investor if the trade was not "solicited" by the foreign broker. Whether a transaction has been solicited depends on the facts and circumstances of that transaction and is addressed by the Commission staff on a case-by-case basis.

You also may invest, without restriction by the U.S. securities laws, in any of the three Canadian mutual funds that have obtained an order to register under Section 7(d) of the Investment Company -- the Great West Variable Annuity Account A, Keystone Fund of Canada, or the Scudder Fund of Canada, Ltd. If a Canadian mutual fund sells its shares in a private offering to 100 or fewer U.S. residents, then you may be able to purchase shares in that private offering. In addition, if a Canadian mutual fund makes a private offering of its securities in reliance on Section 3(c)(7) of the Investment Company Act and you fall within the definition of a qualified purchaser, you may be able to purchase shares in that private offering. Finally, as stated above, if you are a shareholder in a Canadian mutual fund, you could reinvest your dividends in additional shares pursuant to a dividend reinvestment plan, but would generally be prohibited from exchanging between funds or purchasing additional shares outside of a dividend reinvestment plan.

Although the Investment Company Act and Commission interpretations permit foreign funds to offer and sell their securities in private offerings to U.S. residents as summarized above, a foreign mutual fund is not required to do so. We understand that some foreign funds are making a business decision to exclude all U.S. residents from purchasing their shares, even if such purchases can be structured to comply with the U.S. securities laws. As I told you on the phone, we sympathize with your predicament. The decision to close your Canadian account, however, appears to have been made solely by your Canadian brokerage firm and was not precipitated by any change in the U.S. securities laws or the Commission's interpretation of those laws. You might wish to consult with other Canadian brokerage firms or Canadian mutual funds about other possibilities for you to invest lawfully in Canadian securities.

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[5]Because mutual funds must redeem shares at net asset value upon the request of shareholders, these funds' shares generally do not trade on exchanges.

The Commission is always interested in hearing about regulatory burdens arising from its interpretations of, and rules promulgated under, the U.S. securities laws. When adopting its rules, the Commission always considers the burdens that may be imposed on investors and regulated entities. In this area, however, the restrictions described arise from the U.S. securities laws, as adopted by Congress. Within the limits imposed by Congress and consistent with investor protection, the Commission and its staff are receptive to requests to address situations in which the strict application of the U.S. securities laws imposes undue hardship on investors. Currently, the Commission staff and Canadian regulators are exploring whether there are ways to minimize the regulatory burdens that impede the ability of former Canadian residents who move to the U.S. to effectively manage their assets.

If you have any further questions, please feel free to call either me or Eileen Smiley at (202) 942-0660.

Sincerely,

Karrie McMillan

Karrie McMillan
Assistant Chief Counsel by ES

Enclosures