[Vanderbilt Journal of Transnational Law](https://scholarship.law.vanderbilt.edu/vjtl)

Volume 25
Issue 1 *Issue 1 - 1992*

Article 3

4-1992

The European Community's UCITS Directive

Patrick J. Paul

NOTES

The European Community's UCITS Directive: One Model for United States Regulatory Change in a Globalized Securities Market

ABSTRACT

As the twenty-first century approaches, the world is undergoing massive change. Social, political, and economic barriers are being torn down; new alliances are forming, as are new barriers. Economic stability and supremacy have replaced military supremacy in the hierarchy of a nation's policy objectives. The European Community's move toward a single market exemplifies this policy shift.

This Note focuses on one element of these global changes—internationalization of the securities market. The Note begins with an overview of the international securities market and the reasons for its increased globalization. The Investment Company Act of 1940 (the 1940 Act) that, in part, regulates international investment company activity is examined. The author suggests that because section 7(d) of the 1940 Act continues to act as a barrier to foreign investment companies marketing their shares in the United States, and to United States investment companies seeking to market their shares abroad, it should be amended. The Note then evaluates the European Community's UCITS Directive and proposes it as a model for section 7(d) amendment. The author concludes that if investor protection and investment company regulation is substantially similar in a particular state, investment companies domiciled in these states should be permitted to market their shares in the United States, provided United States investment companies are accorded reciprocal treatment.

TABLE OF CONTENTS

I. INTRODUCTION

Internationalization of the securities markets began in the early 1970s when economically motivated financiers, including issuers, investors, and market professionals, sought new and more profitable investment opportunities in foreign markets.[1] Cheap capital became the goal for issuers, while investors yearned for diversity and greater return on their investment portfolios. Modern technology facilitated this trend by providing inexpensive links between distant market players.[2] Technology was responsible, in part, for the rapid growth of world bull markets between

1. *See* Aulana L. Peters & Andrew E. Feldman, *The Changing Structure of the Securities Markets and the Securities Industry: Implications for International Securities Regulation*, 9 MICH. Y.B. INT'L LEGAL STUD. 19, 21-22 (1988).

2. *Id.* at 21-23; *see also* STAFF OF THE U.S. SECURITIES AND EXCHANGE COMMISSION, REPORT ON THE INTERNATIONALIZATION OF THE SECURITIES MARKETS (July 27, 1987) [hereinafter SEC STAFF REPORT].

1982 and 1987,[3] albeit under the yoke of restrictive regulatory policies.[4]

This internationalization has spurred interest in marketing United States investment company services abroad and, reciprocally, in opening United States markets to foreign investment company services.[5] Currently, however, a plethora of restrictive laws, policies, and practices inhibit the free flow of securities in the international marketplace.[6] The legislators and regulators of the world thus face the necessity of formulating securities policies responsive to the trend towards internationalization.

Securities regulators in the international arena must achieve a balance between conflicting national goals and policies, and the desire for uniform regulation.[7] International regulators must protect investors from undue risk and yet provide them with access to the most beneficial investment that, in the current global market, likely may be found abroad. The global securities market collapse of October 19, 1987 perhaps exemplifies best the need for balancing in the international arena. During this collapse, the Dow Jones Industrial Average lost 508 points, or roughly twenty-three percent of its value, on a record trading volume of 604 million shares.[8] The markets of Tokyo, Hong Kong, London, and Sydney also suffered significant declines,[9] clearly indicating the interdependence of these markets.

Despite this apparent interdependence, "few United States securities, and even fewer foreign securities, are traded outside of their home [states]."[10] Nevertheless, around-the-clock global trading and increased

---

3. Peters & Feldman, *supra* note 1, at 22; SEC STAFF REPORT, *supra* note 2, at I-1.

4. *See, e.g.*, SEC STAFF REPORT, *supra* note 2, at II-25; *see also Globalization of Securities Markets: Hearing Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce*, 100th Cong., 1st Sess. 6-7 (1987) (statement of Charles C. Cox, Acting Chairman of the Securities and Exchange Commission).

5. Request for Comments on Reform of the Regulation of Investment Companies, 55 Fed. Reg. 25,322 (1990) [hereinafter SEC Release].

6. *See, e.g.*, SEC STAFF REPORT, *supra* note 2, at II-25 to II-35; Christopher T. Vrountas, Note, *The Necessity and Effectiveness of Barriers to Foreign Direct Investment*, 13 B.C. INT'L & COMP. L. REV. 167 (1990).

7. *See* Daniel L. Goelzer et al., *Securities Regulation in the International Marketplace: Bilateral and Multilateral Agreements*, 9 MICH. Y.B. INT'L LEGAL STUD. 53, 54 (1988).

8. REPORT OF THE PRESIDENTIAL TASK FORCE ON MARKET MECHANISMS 36 (1988).

9. *Id.* at 36, III-16.

10. Joel Seligman, *The Internationalization of the Securities Markets: Preface to a Symposium*, 9 MICH. Y.B. INT'L LEGAL STUD. 1, 1 (1988).

investor demand for pooled investment opportunities underscore the importance of tearing down the barriers to cross-border sales of securities.[11] For example, many states impose more rigorous restrictions on foreign investment companies than on their own investment companies.[12] Similarly, some states, through currency-based and other restrictions, discourage foreign securities investments by their citizens.[13] Even in situations that appear to be equitable to both domestic and foreign securities, a variety of problems may arise that diminish the marketability of foreign securities. For example, if a state requires securities to be sold only by its own banks or licensed broker-dealers, foreign securities necessarily will become secondary in the marketing scheme of these banks or broker-dealers vis-a-vis their own competing products.[14]

The European Community (EC or the Community) took an affirmative step in the direction of global accommodation by issuing a directive[15] for "undertakings for collective investments in transferable securities" (UCITS or the UCITS Directive)[16] to allow financial institutions to operate throughout the Community on the basis of authorization in one member state.[17] Similarly in the United States, the Securities and Exchange Commission (SEC) recently solicited comments[18] on proposed reforms of the regulation of investment companies under the Investment Company Act of 1940[19] (Investment Company Act or the 1940 Act), the Investment Advisers Act of 1940[20] (Investment Advisers Act), the Securi-

---

11. SEC Release, *supra* note 5, at 25,324.

12. *Id.*

13. *Id.*

14. *Id.*

15. For the achievement of their aims and under the conditions provided for in this Treaty, the Council and the Commission shall adopt regulations and directives, make decisions and formulate recommendations or opinions. . . . Directives shall bind any Member State to which they are addressed, as to the result to be achieved, while leaving to domestic agencies a competence as to form and means.

Treaty Establishing the European Economic Community, Mar. 25, 1957, ch. 2, art. 189, 298 U.N.T.S. 11, 78-79 [hereinafter EEC Treaty].

16. Council Directive 85/611, 1985 O.J. (L 375) 3, *as amended by* Council Directive 88/220, 1988 O.J. (L 100) 31 [hereinafter UCITS Directive].

17. *See generally* Tim Dickson, *UCITS Will Help Remove Barriers*, FIN. TIMES, Oct. 31, 1987, at XVI; *Money Go Round: What UCITS Are*, DAILY TELEGRAPH, Feb. 3, 1990, at 34.

18. *See* SEC Release, *supra* note 5, at 25,322-39.

19. Investment Company Act of 1940, Pub. L. No. 76-768, ch. 686, 54 Stat. 789 (1940) (codified as amended at 15 U.S.C. §§ 80a-1 to -64 (1988)).

20. Investment Advisers Act of 1940, ch. 686, § 201, 54 Stat. 847 (1940) (codified as amended at 15 U.S.C. §§ 80b-1 to -21 (1988)).

ties Act of 1933[21] (Securities Act), and the Securities Exchange Act of 1934[22] (Exchange Act), in an effort to respond to rapid international changes in the securities markets. The SEC is seeking to adopt regulations that would make United States investment companies more competitive internationally[23] and is considering another recommendation of amendment to section 7(d) of the Investment Company Act[24] to make it more accommodating to the changes occurring in the world financial markets.[25]

This Note considers the prudence of amending current United States regulatory policy and law, in particular, section 7(d) of the Investment Company Act. Part II begins with an overview of the Investment Company Act and discussion of the regulatory climate that existed at the time of its enactment and the evolution towards present day internationalization. The Note also discusses the compliance problems that foreign investment companies have under the Investment Company Act. Part III examines the EC's move toward a single integrated market. The Note, in particular, examines the EC's UCITS Directive as a possible model for section 7(d) amendment. The Note concludes by suggesting amendment of the 1940 Act using the UCITS Directive as a model for change.

II. United States Regulation of Investment Companies

A. *The Investment Company Act of 1940*

The Investment Company Act of 1940 requires all investment companies,[26] unless otherwise exempt, to register with the SEC prior to offering securities in the United States.[27] The 1940 Act defines investment companies as issuers primarily engaged in the business of investing in,

21. Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (1933) (codified as amended at 15 U.S.C. §§ 77a-77bbbb (1988)).

22. Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (1934) (codified as amended at 15 U.S.C. §§ 78a-78ll (1988)).

23. SEC Release, *supra* note 5, at 25,324.

24. *See infra* note 78 and accompanying text.

25. *See* SEC Release, *supra* note 5, at 25,324.

26. For the statutory definition of investment company, see *infra* note 28 and accompanying text.

27. 15 U.S.C. § 80a-8 (1988) outlines the registration requirements for investment companies. Although an unregistered United States investment company is prohibited from making both public and private offerings, an unregistered foreign investment company is only prohibited from making public offerings. *Compare* 15 U.S.C. § 80a-7(a) (1988) *with* 15 U.S.C. § 80a-7(d) (1988). *See also infra* text accompanying notes 66-70.

holding, or trading securities.[28] The SEC is responsible for the administration and enforcement of the 1940 Act.[29]

While the Securities Act and the Exchange Act essentially were designed to protect investments by the public in traditional types of securities, no similar protection then existed for mutual fund or investment company investments. The first genuine United States investment companies were formed in 1924.[30] Initially, industry growth flourished. Following the market crash of 1929 and the subsequent depression, however, the industry virtually collapsed.[31] The regulatory void, combined with the recognized need for industry regulation following the 1929 crash, prompted Congress to contemplate legislative activity geared toward investment company regulation and eventually resulted in passage of the 1940 Act.[32]

---

28. Section 80a-3(a) states:

> (a) When used in this subchapter, "investment company" means any issuer which—
>
> (1) is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities;
>
> (2) is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or has been engaged in such business and has any such certificate outstanding; or
>
> (3) is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis.
>
> As used in this section, "investment securities" includes all securities except (A) Government securities, (B) securities issued by employees' securities companies, and (C) securities issued by majority-owned subsidiaries of the owner which are not investment companies.

15 U.S.C. § 80a-3(a) (1988).

29. 15 U.S.C. §§ 80a-37 to 46, 80a-49 (1988). The SEC has promulgated rules and regulations pursuant to the Investment Company Act of 1940 at 17 C.F.R. pt. 270 (1991).

30. Dillon, Read & Co. established the U.S. & Foreign Securities Corporation as "the first closed-end company organized as a large, diversified investment enterprise to publicly offer its shares." Richard H. Farina et al., Note, *The Mutual Fund Industry: A Legal Survey*, 44 NOTRE DAME LAW. 732, 776-77 (1969).

31. *See id.* at 781-84.

32. Senator Robert Wagner introduced the original version of the bill that was to become the 1940 Act (S. 3580) on March 14, 1940 during the third session of the seventy-sixth Congress. *See Explanatory Statement by Mr. Wagner on S. 3580*, 86 CONG. REC. 2844-47 (daily ed. Mar. 14, 1940), *reprinted in* IV FEDERAL SECURITIES LAWS: LEGISLATIVE HISTORY—1933-1982 3825-3829 (Securities Law Committee, Federal Bar Association ed., 1983) [hereinafter LEGISLATIVE HISTORY].

The 1940 Act became a form of corporation law applicable to investment companies.[33] Although the scope of the 1940 Act's investment company definition is broad,[34] notable exceptions exist within the statute. For example, banks are not deemed to be investment companies.[35] Additionally, issuers engaged in businesses not intended to be covered under the 1940 Act, but nevertheless presumed to be investment companies by virtue of holding more than forty percent of their assets in investment securities,[36] also are deemed not to be investment companies.[37]

The 1940 Act can be differentiated from other federal securities laws by its meticulous and far-reaching approach to industry regulation. For example, the 1940 Act regulates an individual investment company's disclosure, management, structural, and share distribution practices. It requires detailed disclosure of any company-issued shares.[38] Additionally, the 1940 Act compels disclosure of management policies[39] and permits the SEC to examine the content of sales literature[40] and to scrutinize accounting practices.[41]

The 1940 Act contains no requirement of SEC authorization of securities. Rather, it reinforces the Securities Act by authorizing the SEC to require, by order or rule, that the information contained in a prospectus relating to a "periodic payment plan certificate"[42] or "face-amount cer-

33. Richard M. Klapow, Note, *Foreign Investment Company Law in the United States: The Need for Change in a Global Securities Market*, 14 BROOK. J. INT'L L. 411, 421 (1988).

34. *See supra* note 28 and accompanying text.

35. *See* 15 U.S.C. § 80a-3(c)(3).

36. 15 U.S.C. § 80a-3(a)(3).

37. 15 U.S.C. § 80a-3(b).

38. *See* 15 U.S.C. § 80a-24.

39. 15 U.S.C. § 80a-8(b).

40. 15 U.S.C. § 80a-24(b).

41. 15 U.S.C. § 80a-31.

42. *See* 15 U.S.C. § 80a-24(c).

> "Periodic payment plan certificate" means (A) any certificate, investment contract, or other security providing for a series of periodic payments by the holder, and representing an undivided interest in certain specified securities or in a unit or fund of securities purchased wholly or partly with the proceeds of such payments, and (B) any security the issuer of which is also issuing securities of the character described in clause (A) of this paragraph and the holder of which has substantially the same rights and privileges as those which holders of securities of the character described in said clause (A) have upon completing the periodic payments for which such securities provide.

15 U.S.C. § 80a-2(27).

Senator Wagner noted that an "installment investment or periodic payment plan is in essence a device to sell investment trust or investment company shares to the public on tificate"[43] be presented in the form and order and include any summaries the SEC may deem appropriate to protect the public interest or investors.[44] Unlike the Securities Act, the 1940 Act requires that three copies of any "advertisement, pamphlet, circular, form letter, or other sales literature addressed to or intended for distribution to prospective investors"[45] be filed with the SEC within ten days of the distribution of the prospectus through the mails or interstate facilities in connection with a public offering by any registered company (other than a closed-end company).[46]

The 1940 Act also contains specific restrictions on the issuance of securities.[47] For example, any public offering by a newly organized investment company is prohibited unless the company has a net worth of at least one hundred thousand dollars, or has previously made a public offering of its securities at a time when it had a net worth of one hundred thousand dollars.[48] Implementation of this provision is achieved by

---

the installment plan." SENATE COMM. ON BANKING AND CURRENCY, INVESTMENT COMPANY ACT OF 1940 AND INVESTMENT ADVISERS ACT OF 1940, S. REP. NO. 1775, 76th Cong., 3d Sess. 1, 3 (1940), *reprinted in* LEGISLATIVE HISTORY, *supra* note 32, at 3830, 3832.

43. *See* 15 U.S.C. § 80a-24(c). Senator Wagner further noted:

> [F]ace-amount certificates are in essence contracts between the corporation which issues them and the purchaser, whereby in consideration of the payment of certain specified installments the corporation agrees to pay to the purchaser at maturity a definite sum, the 'face amount' of the certificate; or to pay prior to maturity a specified surrender value of the certificate.

S. REP. NO. 1775, *supra* note 42, at 3d Sess. 1, 3, *reprinted in* LEGISLATIVE HISTORY, *supra* note 32, at 3832.

44. 15 U.S.C. § 80a-24(c).

45. 15 U.S.C. § 80a-24(b).

46. *Id.* A closed-end company does not publicly offer its shares on a continuous basis and does not issue redeemable securities. "Rather, a closed-end company issues, in a traditional underwritten offering, a fixed number of shares that are subsequently traded on a securities exchange or in the over-the-counter market." SEC Release, *supra* note 5, at 25,324.

47. Section 14(a) of the 1940 Act provides:

> [A]rrangements will be made whereby any proceeds so paid in, as well as any sales load, will be refunded to any subscriber on demand without any deduction, in the event that the net proceeds so received by the company do not result in the company having a net worth of at least $100,000 within ninety days after [the effective date of the Securities Act registration statement].

15 U.S.C. § 80a-14(a)(3)(c). At any time thereafter, the SEC may issue a stop order pursuant to the Securities Act and may suspend or revoke the company's registration under the 1940 Act. 15 U.S.C. § 80a-14(a).

48. 15 U.S.C. § 80a-14(a). Additionally, a public offering would be prohibited if, as a condition of registering under the Securities Act, the company agreed not to issue any

prohibiting any public offering of pre-organization certificates or subscriptions for a proposed investment company.[49] Additionally, registered face-amount certificate companies may not issue their securities except for cash or other securities.[50] Registered management companies are subject to similar provisions. They are permitted, however, to issue securities as a dividend or distribution to their existing security holders or in connection with a reorganization.[51]

The exact requirements imposed on investment companies by the 1940 Act vary depending on the type of company.[52] The different types of investment companies include face-amount certificate companies, unit investment trust companies, and management companies.[53] A face-amount certificate company issues debt securities that investors purchase by periodic installments or by a lump sum payment.[54] A unit investment trust company, organized under a trust indenture or similar instrument, invests in a largely fixed portfolio of securities and issues redeemable securities.[55] Finally, a management investment company may be distinguished from a face-amount certificate company or unit investment trust company in that its investment portfolio usually is managed by an external adviser whose compensation is based on a percentage of the com-

---

security or to receive any subscription proceeds until firm agreements had been made by no more than twenty-five responsible persons to purchase sufficient securities from the company to provide it with a net worth of at least one hundred thousand dollars. 15 U.S.C. § 80a-14(a)(3).

49. 15 U.S.C. § 80a-7(c).

50. 15 U.S.C. § 80a-18(j)(3). These types of companies are limited to issuing the following: face-amount certificates; common stock with a par value and without preference as to dividends or distributions and having at least equal voting rights with any outstanding security of the same company; or short-term payment or promissory notes privately issued in consideration of any loan or its renewal. *See* 15 U.S.C. § 80a-18(j)(1).

51. 15 U.S.C. §§ 80a-22(g), 80a-23(a).

52. For example, in addition to the requirements discussed in the text accompanying *supra* notes 26-46, the 1940 Act imposes requirements on the following matters: composition and election of boards of directors, exchange offers, pyramiding, investment policies and types of investments, investment advisory and underwriting contracts, transactions with affiliates, capital structure, custodial arrangements, portfolio evaluation, fidelity bonds, codes of ethics, disclosure of the source of dividends and distributions, proxies, loans, sales and redemptions, repurchases, use of fund assets for distribution, reorganizations, reports to shareholders and the SEC, books and records, and accountants and auditors. SEC Release, *supra* note 5, at 25,323.

53. *See* 15 U.S.C. § 80a-4.

54. 15 U.S.C. §§ 80a-4(1), 80a-2(15).

55. 15 U.S.C. § 80a-4(2). The unit investment trust company does not have a board of directors. 15 U.S.C. § 80a-4(2)(B).

pany's assets.[56]

Fundamental policy objectives underlie each requirement of the 1940 Act.[57] The policy concerns that existed in 1940, however, differ vastly from those in today's rapidly-globalizing market. When the Investment Company Act was enacted, only sixty-eight investment companies with assets of 488 million dollars existed.[58] The numbers have grown drastically to more than 3,500 investment companies with assets in excess of 1.2 trillion dollars.[59] Investment companies currently are enjoying unparalleled growth as the public increasingly invests both directly and indirectly, through vehicles such as employer retirement plans.[60] This growth has made investment companies major players in today's financial markets, in parity with banks, savings and loan associations, brokerage houses, and insurance companies.[61] Although the Investment Company Act has been amended numerous times[62] since its 1940 enactment, many sections remain in their original form. As the world's securities markets undergo increased globalization, some of the provisions of the 1940 Act that remain unchanged tend to detract from, rather than contribute to, the continuing viability of the 1940 Act. Section 7(d) is one section in particular that many commentators, regulators, and legislators have suggested amending in order to keep up with the globalization trend.

---

56. *See* 15 U.S.C. § 80a-4(3); SEC Release, *supra* note 5, at 25,323 n.5.

57. For example, section 12(d)(1) (15 U.S.C. § 80a-12(d)(1)) seeks to prevent a multitude of costs and fees from being imposed on the investor as a result of pyramiding the ownership and control of investment companies. *See* SEC Release, *supra* note 5, at 25,323. The 1940 Act also protects investors from loss pursuant to self-dealing by insiders and from dilution of shareholder value through excessive leveraging. *Id.*

58. SEC Release, *supra* note 5, at 25,323.

59. *Id.*

60. *Id.*

61. *Id.*

62. *See, e.g.*, Amendments to the Investment Company Act of 1940, Pub. L. No. 83-577, § 402, 68 Stat. 688, 689 (Aug. 10, 1954) (amending section 24); Amendments to the Bank Holding Company Act of 1956, Pub. L. No. 89-485, § 13(i), 80 Stat. 236, 243 (July 1, 1966) (amending section 3); Investment Company Amendments Act of 1970, 84 Stat. 1413, Pub. L. No. 91-547 (Dec. 14, 1970) (amending sections 2, 3, 9, 10, 11, 12, 15, 17, 18, 19, 22, 24, 25, 26, 32, 33, 36, 43 and 44; adding to sections 27 and 28); Small Business Investment Act Amendments of 1972, Pub. L. No. 92-595, § 319, 86 Stat. 1314, 1315 (Oct. 27, 1972) (amending section 18); Securities Acts Amendments of 1975, Pub. L. No. 94-29, § 29, 89 Stat. 97, 166 (June 4, 1975) (amending sections 3, 9, 10, 13, 15, 16, 18, 32, 36 and 49); Small Business Investment Incentive Act of 1980, Pub. L. No. 96-477, §§ 101-203, 94 Stat. 2275, 2275-90 (Oct. 21, 1980) (amending sections 2, 3, 6 and 47; adding sections 54 through 65); Act of Oct. 13, 1;982, Pub. L. No. 97-303, § 5, 96 Stat. 1409, 1409-10 (Oct. 13, 1982) (amending section 2).

B. *Section 7(d) as a United States Barrier to Foreign Investment Companies*

Section 7 of the 1940 Act places restrictions on the activities of investment companies.[63] The section 7 restrictions applicable to foreign investment companies, however, differ greatly from those applicable to United States investment companies. Section 7(a) prohibits any domestically organized investment company from offering or selling any security, or interest in any security, whether or not the company is the issuer, and from engaging in interstate commerce unless registered under section 8.[64]

Conversely, section 7(d) of the 1940 Act, applicable only to companies not organized under the laws of the United States or any state, restricts these companies only from making a public offering of its securities except pursuant to SEC order.[65] The SEC order would allow a foreign investment company to register under the 1940 Act and "to make a public offering of its securities."[66] Section 7(d), nor any other section, does not prohibit private offerings of foreign investment companies in the United States. The SEC, however, has addressed the private offerings of securities by foreign investment companies.[67] It has advised that a foreign investment company privately may issue securities in the United States provided the private domestic offering is not integrated with a foreign public offering.[68]

The SEC may issue an order permitting registration of a foreign investment company for the purpose of a public offering if it can determine that the provisions of the 1940 Act are enforceable and that the order permitting registration would be "otherwise consistent with the public interest and the protection of investors."[69] To grant an order, the SEC must, in addition to making the customary public interest and investor protection findings, determine that the enforcement of the 1940 Act against the foreign investment company applicant is "both legally and

63. 15 U.S.C. § 80a-7(a).

64. *Id.*

65. 15 U.S.C. § 80a-7(d).

66. *Id.*

67. James K. Mitchell, Esq., SEC No-Action Letter, [1975-1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,392, at 86,047 (June 24, 1975). The SEC noted that "if the investment company's private offering [in the United States] were coincident with or close in time with an offering of its securities abroad, . . . [this] could affect the . . . [private offering status] in this country and might put the company in violation of Section 7(d)." *Id.*

68. *Id.*

69. 15 U.S.C. § 80a-7(d).

practically feasible effectively."[70]

In practice, this threshold has been particularly difficult to meet, especially in civil, rather than common, law states.[71] The SEC essentially "must find that investors in foreign investment companies enjoy the same protections as investors in domestic investment companies."[72] Although the SEC tends to favor common law states, even in those states it has required "that the fund charter and by-laws include certain substantive provisions of the 1940 Act, that a majority of fund directors and officers be United States citizens, and that a majority of such citizens reside in the United States."[73] In effect, these conditions require foreign investment companies to become de facto domestic companies.

Although section 7(d) prevents foreign funds from selling their shares in the United States, foreign money managers may enter the United States investment company market through the utilization of mirror funds.[74] For example, a foreign investment manager may organize a fund in the United States that invests in the same type of securities as the foreign investment company and register the fund under the 1940 Act.[75] Many United States investment companies use this mechanism to surmount existing barriers to foreign markets. Thus, funds seemingly international in nature are often mirror funds that allow domestic investment companies to invest directly in foreign securities.[76]

The SEC has acknowledged that section 7(d) impedes reciprocity in the currently globalizing securities market and has suggested amendment.[77] The proposed Foreign Investment Company Amendments Act of

---

70. *Id.*

71. Mary S. Podesta, *Cross Border Sales of Investment Management Services: Issues Under the Investment Advisers and Investment Company Acts, in* INTERNATIONALIZATION OF THE SECURITIES MARKETS—BUSINESS TRENDS AND REGULATORY POLICY 7, 9 (ALI-ABA Course of Study ed., 1989).

72. *Id.* at 9.

73. *Id.*

74. *See* SEC Release, *supra* note 5, at 25,325 n.19 (citing Investment Company Act Release No. 13691 (Dec. 23, 1983)). A mirror fund is an investment company organized under the laws of the United States, which "invest[s] primarily in the securities of foreign issuers in which the foreign investment company invests." Applications of Foreign Investment Companies Filed Pursuant to Section 7(d) of the Investment Company Act of 1940, Release No. IC-13691, Fed. Sec. L. Rep. (CCH) ¶47,662, at 36,614, 36,616 [hereinafter Applications of Foreign Investment Companies].

75. Podesta, *supra* note 71, at 10.

76. *Id.*

77. *See* Letter from John S.R. Shad, Chairman, SEC, to the Honorable Thomas P. O'Neill, Jr., Speaker, United States House of Representatives (Jan. 31, 1984) (transmitting Proposed Foreign Investment Company Amendments Act of 1984 and Memoran-

1984 (1984 Amendments Act) would have facilitated foreign investment company registration with the SEC by authorizing the SEC to exempt certain foreign investment companies from any provision of the Investment Company Act if it found that compliance would be "unduly burdensome" and that investor protections comparable to those of the 1940 Act were provided either by foreign law under which the company operated or by specific conditions agreed to by the company.[78] Under the proposed amendment, the SEC also would have been required to find that it was both legally and practically feasible effectively to enforce those provisions of the 1940 Act from which exemptions were not granted.[79] Although the 1984 Amendments Act would have allowed the SEC to consider comparable foreign regulation in granting 7(d) exemptions, it would not have required that United States investment companies be afforded similar treatment under the foreign regulatory scheme as a condition for exemption.[80] The 1984 Amendments Act, however, never was introduced in Congress.[81]

Extension of the 1940 Act to foreign investment companies continues

---

dum of the SEC in Support of the Foreign Investment Company Amendments Act of 1984) [hereinafter Shad Letter].

78. *Id.* at 4. The proposed act further provided:

> (3) the exemption is consistent with the protection of investors and the purposes fairly intended by the policy of this title, and (4) such company is not operated for the purpose of evading the provisions of this title. For purposes of this subsection, an operating foreign investment company is a company organized or created under the laws of a foreign country which at all times during the three year period immediately preceding the filing of an application for registration under this title has had a minimum of 500 non-United States shareholders and $100 million in net assets, and which is primarily engaged in investing in securities of non-United States issuers.

Id. at app. (Proposed Foreign Investment Company Amendments Act of 1984, § 2).

The Investment Company Institute (ICI) claimed that the 1984 Amendments Act "would have provided an unfair and unjustified one-way street, by relaxing the restrictions of [s]ection 7(d) to permit more foreign investment companies to compete in the [U.S.] market, without providing for [U.S.] investment companies' reciprocal access to foreign markets." Investment Company Institute, Comments on the Reform of Regulation of Investment Companies, Release No. 33-6868, 34-28124, IC-17534, IA-1234, International Series Release No. 128, File No. S7-11-90, at 66 (Oct. 5, 1990) [hereinafter ICI Comments].

79. Shad Letter, *supra* note 77, at 5; *see also* SEC Release, *supra* note 5, at 25,325 n.18; Podesta, *supra* note 71, at 10.

80. *See* Shad Letter, *supra* note 77, at 4. The SEC, however, would have been required "to find that an exemption [was] consistent with the protection of investors and the purposes fairly intended by the policy of the [1940] Act." *Id.*

81. Podesta, *supra* note 71, at 10.

to be riddled by a variety of problems.[82] Section 7(d) presents an insurmountable hurdle for foreign investment companies wishing to market their shares publicly in the United States, even with the current exemption provisions.[83] Despite a number of section 7(d) applications, the SEC has not granted any exemptions within the last thirty years.[84]

In response to criticism from other states for its failure to grant exemptions, the SEC stated its position on section 7(d) in an interpretative release issued in September 1975.[85] Prior to 1975, the SEC had addressed only Canadian-based offerings.[86] In the 1975 release, the SEC required, as a minimum prerequisite to filing an application pursuant to section 7(d), that a foreign investment company demonstrate that it:

> (1) is a bona fide and established company, (2) is subject to actual regulation by an appropriate foreign governmental authority, (3) would not be dependent solely on sales in the United States, (4) would be a vehicle for investment primarily in foreign securities, (5) would subject itself and its management to service of process, and (6) would provide adequate disclosure to investors in the United States.[87]

The SEC Guidelines also set minimum standards with which an applicant must conform to receive favorable consideration. These standards require that on the date of registration an investment company has been in operation for three years and has fifty million dollars in net assets, but no less than twenty-five million dollars in net assets, when it makes an offering in the United States.[88] Additionally, an investment company applicant must have greater than sixty percent of the value of its portfolio invested in securities of issuers in its home state or at least seventy-five

---

82. *See, e.g.*, Shad Letter, *supra* note 77, at 3-4.

83. Albert Francke III, *International Mutual Funds*, in 2 INTERNATIONAL FINANCIAL LAW 57, 61 (Robert S. Rendell ed., 2d ed. 1983).

84. *Id.*

85. Commission Policy and Guidelines for Filing of Application for Order Permitting Registration under the Act and Sale of Shares in the United States of Foreign Investment Companies, Fed. Sec. L. Rep. (CCH) ¶47,661, at 36,609 (Sept. 26, 1975) [hereinafter Policy and Guidelines].

86. In 1954, the SEC promulgated Rule 7(d)-1, titled "Specification of conditions and arrangements for Canadian management investment companies requesting order permitting registration." 17 C.F.R. 270.7d-1 (1991). Rule 7(d)-1 authorizes a Canadian management investment company to obtain an order pursuant to section 7(d) if it complies with certain specified requirements that are more lenient than those imposed on other foreign states. *See id.* This rule was adopted "only after the [SEC] developed case-by-case experience with Canadian investment companies." Policy and Guidelines, *supra* note 85, ¶47,661, at 36,610.

87. Policy and Guidelines, *supra* note 85, ¶47,661, at 36,612.

88. *Id.*

percent invested in securities of non-United States issuers.[89] An applicant also must agree to provide all United States investors with a prospectus that is subject to strict disclosure requirements.[90]

In addition to meeting these minimum standards, a foreign investment company applicant also must demonstrate compliance with the enforceability standard of section 7(d).[91] The SEC has determined that this standard is satisfied only when a foreign investment company can clearly show: (1) United States investors will benefit from the protections provided by both federal securities laws and common law; (2) investors will have both a convenient legal forum and a convenient means of enforcing judgments pursuant to the exercise of their rights; and (3) the SEC will be able to enforce the applicable federal securities law against the foreign investment company.[92]

Although bound by current standards, the SEC has acknowledged that section 7(d) is inadequate in today's rapidly globalizing securities market.[93] The SEC has conceded that differences in foreign laws and capital markets may prevent a foreign investment company's compliance with this provision.[94] In December 1983, the SEC supplemented its 1975 guidelines by advising investment companies domiciled in civil law states to organize separate companies in the United States and to offer shares of these companies in the United States, instead of filing section 7(d) applications to sell their own shares.[95] The SEC continually has sup-

---

89. *Id.*

90. *Id.* According to SEC Policy and Guidelines, the prospectus must state clearly:

> (a) the name of the applicant including, if not already part of such name, the name of the country under whose laws applicant is organized; (b) all conditions and arrangements to which applicant is subject pursuant to any order obtained under the Act; (c) all material regulatory provisions of the Act to which applicant is not subject by the terms of any such order; (d) a copy, in English, of the applicable foreign law to which applicant is subject; and (e) any other information which is necessary or appropriate to meet the disclosure requirements of the Act and the Securities Act of 1933.

Id.

91. "[I]f the Commission finds that, by reason of special circumstances or arrangements, it is both legally and practically feasible effectively to enforce the provisions of this subchapter against such company and that the issuance of such order is otherwise consistent with the public interest and the protection of investors." 15 U.S.C. § 80a-7(d).

92. Kredietbank, SEC No-Action Letter, [1973-1974 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶79,824, at 84,228-29 (Mar. 4, 1974).

93. *See supra* notes 77-81 and accompanying text.

94. *See, e.g.*, Shad Letter, *supra* note 77 at 4; Policy and Guidelines, *supra* note 85, ¶47,661, at 36,610.

95. Applications of Foreign Investment Companies, *supra* note 74, ¶47,662, at 36,614-16.

ported amendment of current law to allow foreign investment companies a reasonable opportunity to sell shares publicly in the United States.[96] Unfortunately, foreign investment companies that create separate United States subsidiaries or affiliates with distinct personnel servicing only United States clients "may divide scarce advisory personnel with expertise in specialized markets and reduce capital resources available to each entity, thus diminishing services to both United States and foreign advisory clients."[97] Arguably, the barrier to the United States markets that section 7(d) poses will not justify easing foreign restrictions on United States investment companies.

Generally, two problems confront foreign investment companies in their attempt to market shares in the United States pursuant to section 7(d). First, structural and operational differences that exist between foreign and domestic investment companies are likely to prevent compliance with the 1940 Act.[98] Second, administrative concerns, such as the complexity and expense of filing an application and providing the SEC with English translations of applicable foreign law, may dissuade potential applicants.[99] Against this backdrop, the SEC, once again, is considering a legislative proposal to amend section 7(d).[100]

C. *Policies Underlying the Drive for Section 7(d) Amendment*

Most international regulators would agree that regulatory schemes must adapt to changing times. The question then is not whether to regulate, but rather to what extent and in what manner. One commentator has observed two concepts that she believes underlie most regulatory initiatives in today's global markets: (1) that the elimination of barriers to entry or, liberalization of access to the marketplace enhances that market's efficiency; and (2) that internationalization results in market inter-

---

96. *See supra* notes 77-81 and accompanying text. From 1954 to 1973, the SEC issued 19 exemptive orders under section 7(d), which allowed foreign investment companies to register. Thirteen of these executive orders were issued to Canadian investment companies. The others were issued to investment exemptive orders organized under the laws of states with common law traditions. *See* SEC STAFF REPORT, *supra* note 2, at VI-10 to -13 & n.10; Podesta, *supra* note 71, at 9-10. Only 4 of the 19 investment companies (3 Canadian companies and 1 South African company) that received exemptive orders were active as of 1989. Podesta, *supra* note 71, at 9-10.

97. SEC Release, *supra* note 5, at 25,325.

98. *See* Applications of Foreign Investment Companies, *supra* note 74, ¶47,662, at 36,615.

99. *Id.* at 36,616.

100. *See* SEC Release, *supra* note 5, at 25,322.

dependence.[101] These concepts accordingly have resulted in three regulatory trends in the internationalized marketplace: harmonization, increased willingness to enter cooperative agreements, and reciprocity.[102]

As United States investment companies seek greater opportunities abroad, and as certain foreign markets facilitate these opportunities, the United States regulatory scheme must adapt to changing times. Certainly, section 7(d) does not assist United States investment companies in their attempts to market shares abroad. A United States investment company simply cannot expect to be received favorably abroad when a foreign entity is unlikely to receive favorable treatment in the United States. Section 7(d) poses difficulty not only for foreign investment companies seeking access to United States markets, but also poses a substantial administrative burden on the SEC. Additionally, the current regulatory scheme, which essentially is an ad-hoc application process,[103] arguably leaves too much to the subjective whim of the SEC in its determination of whether any particular foreign investment company may market its shares in the United States.

Essentially, the 1940 Act extends domestic law, drafted and enacted with a view solely to the United States investment company industry at a time when that industry differed significantly in size and strategy,[104] to foreign investment companies. Consequently, the jingoistic requirement that foreign investment companies be structured and operated based on the United States concept evolved.[105] This aggressive requirement, how-

101. Aulana L. Peters, *Overview of International Securities Regulation*, 6 INT'L TAX & BUS. LAW. 229, 230 (1988).

102. *Id.* at 230.

103. "[T]he Commission has determined that certain factual and legal questions which are crucial to the determinations which must be made pursuant to the Act can best be resolved on a case-by-case basis." Policy and Guidelines, *supra* note 85, ¶47,661, at 36,609.

104. *See supra* notes 30-33 and accompanying text.

105. The legislative history of the 1940 Act is marked by a theme of protectionism. Clearly, globalization of the securities markets had not yet begun. This attitude is reflected in part in certain of Senator Wagner's introductory comments. For example, Senator Wagner began his explanatory statement on the 1940 Act by noting:

> Investment trusts and investment companies constitute one of the important media for the investment of savings of the American public and an important factor in our national economy. . . . [T]hey control or exercise a significant influence in a great variety of industrial enterprises, public utiities, insurance companies, banks, etc. . . . The underlying purpose of the legislation is not merely to insure to investors a full and fair disclosure . . . but to eliminate and prevent those deficiencies and abuses in these organizations which have contributed to the tremendous losses sustained by their security holders.

Explanatory Statement by Mr. Wagner on S. 3580, 86 Cong. Rec. 2844-47 (daily ed.

ever, necessarily assumes that the United States concept is the best approach to investment company regulation. The United States concept clearly is not universally accepted.[106] Although foreign regulatory approaches may provide similar levels of investor protection, foreign investment companies operating under these foreign approaches cannot register to market their shares in the United States because they are unable to comply with the requirements of the 1940 Act.[107] The EC has responded to similar cross-border reciprocity problems in a variety of ways, some of which are discussed in the next section.

III. The European Community Goal of an Integrated Single Market

A. *Legislative Background—The Treaty of Rome, The White Paper, and The Single European Act*

The Treaty of Rome,[108] which established the European Economic Community, empowered the EC Council and Commission to issue directives encouraging free movement of capital goods and services across internal boundaries within the Community.[109] Article three of the Treaty of Rome foresaw the creation of a cooperative framework within which competition would thrive and the conflicting laws of individual member states would be harmonized toward the end of an integrated single market.[110] Although the goals were clear, no deadline was placed on their attainment.[111]

The 1985 EC White Paper (the White Paper)[112] on completing the internal market provided the first and only deadline for achievement of

---

Mar. 14, 1940), *reprinted in* LEGISLATIVE HISTORY, *supra* note 32 at 3825.

106. *See generally* OECD REPORT, The Committee on Financial Markets International Trade in Services: Securities (Paris 1987).

107. *See supra* notes 94-97 and accompanying text.

108. *See* EEC Treaty, *supra* note 15, 298 U.N.T.S. at 11. The original EC member states and signators to the Treaty of Rome were Belgium, France, Italy, Luxembourg, the Netherlands, and West Germany. *Id.*

109. *Id.* art. 57, 59, 62, 67, 298 U.N.T.S. at 39-42.

110. *See, e.g.*, Brian Cregan, Director, Financial Services Industry Association, Financial Services And 1992, Paper Delivered to the Institute of Chartered Accountants 3 (June 1989) (unpublished transcript on file with the *Vanderbilt Journal of Transnational Law*).

111. *Id.*

112. Commission of the European Communities, *Completing the Internal Market: White Paper from the Commission to the European Council* (June 1985), COM(85)310 final, *reprinted in* AUDREY WINTER ET AL., EUROPE WITHOUT FRONTIERS: A LAWYER'S GUIDE app. A at A-3 to A-59 (1989) [hereinafter EC White Paper].

these goals—1992.[113] The White Paper called for the removal of all physical, technical, and fiscal barriers to the free movement of goods and services between and among the member states.[114] In an attempt to attain more efficient harmonization of the member states' potentially divergent legislative restrictions regarding the free movement of goods, the White Paper sought harmonization of essential requirements only.[115] Regarding the creation of a common market for services, the White Paper enunciated the principle of "home country control"[116] under which the primary responsibility for the supervision of a financial entity rests with the "competent authorities of its Member State of origin."[117] The White Paper also provided, however, that the competent authorities of the member state receiving the particular service would have a "complementary [supervisory] role."[118] Although the White Paper recognized the need for some minimum regulatory harmonization, it provided that "the need to reach agreement on this must not be allowed further to delay the necessary and overdue decisions."[119]

The EC provided a constitutional basis for the White Paper via the Single European Act of 1986 (Single European Act).[120] The Single European Act amended the treaties creating the EC[121] and provided that the internal market would consist of "an area without internal frontiers

113. "The Commission will be asking the European Council to pledge itself to completion of a fully unified internal market by 1992 and to approve the necessary programme together with a realistic and binding timetable." *Id.* at A-8.

114. *See id.* pts. 1-3, at A-13 to A-60.

115. Paragraph 68 of the White Paper provides:

> The practice of incorporating detailed technical specifications in Directives has given rise to long delays because of the unanimity required in Council decision making. Henceforth, in those sectors where barriers to trade are created by justified divergent national regulations . . . legislative harmonization will be confined to laying down the *essential* requirements, conformity with which will entitle a product to free movement within the Community.

Id. para. 68, at A-23 to A-24 (emphasis added).

116. *Id.* para. 103, at A-32.

117. *Id.*

118. *Id.*

119. *Id.*

120. 1987 O.J. (L 169) 1 [hereinafter Single European Act]. The Single European Act was signed at Luxembourg on Feb. 17, 1986, and at the Hague on Feb. 28, 1986. The Act became effective on July 1, 1987. *Id.* at 29.

121. The Single European Act amended three separate treaties, including the Treaty Establishing the European Coal and Steel Community, Apr. 18, 1951, 261 U.N.T.S. 140; the Treaty Establishing the European Economic Community, Mar. 25, 1957, 298 U.N.T.S. 11; and the Treaty Establishing the European Atomic Energy Community, Mar. 25, 1957, 298 U.N.T.S. 167. *See* 1987 O.J. (L 169) at 4-13.

in which the free movement of goods, persons, services, and capital is ensured."[122] The EC since has taken tremendous strides toward attainment of a single integrated market.

The Cecchini Report,[123] which profiled the economic efforts of European integration, estimated that the potential medium-term gains in economic welfare—those accruing within three to five years—from completion of the internal market will total almost 216 billion European currency units (ECUs), or in excess of five percent of Europe's 1988 gross domestic product.[124] The Cecchini Report further estimated medium-term gains of twenty-two billion ECU, or twenty-four billion dollars, from integrating the EC financial services markets.[125] The principal directives integrating financial services within the member states are the Capital Movements Directive,[126] the Second Banking Directive,[127] and the proposed Investment Services Directive.[128]

The Capital Movements Directive (the Directive) required all member states to abolish restrictions on movements of capital between persons resident in member states by July 1, 1990.[129] Essentially, member states may restrict the free flow of capital only in extraordinary circumstances.[130] In any event, a member state may not restrict capital movements for more than six months.[131] The Directive does not provide member states with the power to alter capital flows to or from nonmember states.[132] The Directive, however, does order member states to "endeav-

122. Single European Act, *supra* note 120, at art. 13, 1987 O.J. (L 169) at 7.

123. PAOLO CECCHINI, THE EUROPEAN CHALLENGE, 1992: THE BENEFITS OF A SINGLE MARKET (1988).

124. *Id.* at 84.

125. *Id.* at 37. The EC financial services sector consists of the banking, insurance, and securities industries.

126. Council Directive of 24 June 1988 for the Implementation of Article 67 of the Treaty, 1988 O.J. (L 178) 5 (1988) [hereinafter Capital Movements Directive].

127. Second Council Directive of 15 December 1989 on the Coordination of Laws, Regulations and Administrative Provisions Relating to the Taking Up and Pursuit of the Business of Credit Institutions and Amending Directive 77/780/EEC, 1989 O.J. (L 386) 1 [hereinafter Second Banking Directive].

128. Commission Proposal for a Council Directive on Investment Services in the Securities Field, 1989 O.J. (C 43) 7 [hereinafter Proposed Investment Services Directive]; *see also* Philip M. Johnson & Isaac Finkle, *The 1992 European Investment Community: An Exclusive Club?*, INT'L FIN. L. REV., Mar. 1989, at 35.

129. Capital Movements Directive, *supra* note 126, at arts. 1, 6, 1988 O.J. (L 178) at 6-7. Spain, Portugal, Ireland, and Greece were provided with additional time to comply. *Id.* art. 6, 1988 O.J. (L 178) at 7.

130. *Id.* art. 3, 1988 O.J. (L 178) at 6.

131. *Id.*

132. *Id.* art. 7, 1988 O.J. (L 178) at 7.

our to attain" the same degree of liberalization regarding transfers to or from nonmember states as they are required to attain regarding transfers to or from other member states.[133]

Under the EC's Second Banking Directive, when a bank is chartered in one member state, it automatically acquires the power to open branches and to transact business in all member states.[134] Banks are permitted to offer any of the delimited services, which include the core banking services of deposit-taking, lending, trust services, and participation in securities issuances.[135] Perhaps most important, the Second Banking Directive provides a single license system that allows banks to operate in all twelve member states based on licensing in any one member state.[136] Article 9 of the Second Banking Directive outlines the guidelines for non-EC banks.[137] Essentially, the EC will permit the operation of non-EC banks and other credit institutions on a case-by-case basis, depending, in large part, on the reciprocity accorded to EC member states.[138]

The proposed Investment Services Directive permits an investment firm authorized to do business in one member state to establish branches and conduct business in any other member state, with the consent of its home state regulators.[139] Like the Second Banking Directive, the proposed Investment Services Directive provides for the assurance of reciprocity.[140]

B. *The UCITS Directive*

1. Legislative Overview

The EC's UCITS Directive, adopted in 1985 and amended in 1988,[141] establishes equal protection for investors throughout the EC and promotes the circulation of securities despite the member states' differing

133. *Id.*

134. Second Banking Directive, *supra* note 127, at arts. 2, 13, 19-21, 1989 O.J. (L 286) at 4, 7, 10-11.

135. *Id.* art. 18, annex, 1989 O.J. (L 386) at 9-10, 13.

136. *Id.* arts. 2, 13, 19-21, 1989 O.J. (L 386) at 4, 7, 10-11.

137. *Id.* art. 9, 1989 O.J. (L 386) at 5.

138. *Id.*

139. Proposed Investment Services Directive, *supra* note 128, at art. 4(1), 1989 O.J. (C 43) at 8.

140. *Id.* art. 6, 1989 O.J. (C 43) at 9.

141. *See supra* note 16 and accompanying text.

regulatory schemes.[142] The UCITS Directive is designed to permit UCITS to operate within the EC on a common basis, without the confusion caused by the conflicting laws of the member states.[143] This Directive seeks to permit one member state's authorization to suffice for the entire EC, while providing sufficient investor protection through required compliance with local marketing regulations.[144]

A member state may impose stricter requirements than the minimum set forth in the UCITS Directive.[145] Nevertheless, because the stricter requirements would be applicable only to UCITS authorized in that member state, an EC member state most likely would not adopt stricter requirements given the competitive disadvantage under which its own UCITS then would have to operate.[146] This competitive disadvantage would exist not only in the particular member state's domestic market, but also in the capital markets of other EC member states.[147]

EC member states were required to implement the provisions of the UCITS Directive no later than October 1, 1989.[148] Currently, the foremost issue pertaining to the progress of the UCITS Directive is its implementation in the legislatures of member states.[149] As of October 1, 1989, only five states were fully on schedule, and only eight member states had implemented the Directive as of December 1990.[150]

2. UCITS—A Working Definition

Before further analyzing the UCITS directive, the establishment of a working definition of UCITS will be helpful. A UCITS is a pooled form of investment in which investors may deposit money that will be managed by a fund group and invested in shares or government bonds, de-

---

142. *See* UCITS Directive, *supra* note 16, 1985 O.J. (L 375) pmbl. at 3.

143. *See* Albert Francke, III, *Capital Flows Between Countries: Reciprocal Arrangements for the Sale of Shares in Mutual Funds,* 1987 COLUM. BUS. L. REV. 365, 366 (1987).

144. *Id.* at 366.

145. *Id.*

146. *Id.*

147. *Id.*

148. UCITS Directive, *supra* note 16, at art. 57(1), 1985 O.J. (L 375) at 13. Greece and Portugal were permitted to postpone implementation until April 1, 1992. *See id.* art. 57(3), 1985 O.J. (L 375) at 14.

149. As of December 1990, Belgium and Italy had not yet incorporated the UCITS into their national laws, although other member states had incorporated it in varying degrees and forms. *See UCITS: An End of Year Review,* FIN. TIMES, Financial Regulation Report, Dec. 1990 *available in* LEXIS, Nexis Library, FRR File.

150. *Id.*

pending on the goals of the fund.[151] UCITS must be ninety percent invested in transferable securities, such as stocks and shares.[152] UCITS, like unit trusts,[153] are open-ended funds subject to no limit on the number of units that can be issued.[154]

These pooled investments result in transnational capital flows that assist the financing of trade and industry.[155] One factor affecting the freedom of this capital flow is the presence or absence of significant government regulations.[156] For example, while the host member state may apply its marketing rules when they do not conflict with the Directive, the authorizing state is generally responsible for supervision and control.[157]

A mutual fund seeking to offer shares outside its home state must follow the notification procedures that require advance notice to the home and host states.[158] Unless the host state determines that its marketing rules would be violated, the undertakings may be marketed there two months after giving notice.[159] As the Directive applies only to collective, open-ended investment undertakings,[160] the object of the undertakings must be the collective investment of publicly raised capital in transferable securities.[161] Additionally, the undertakings must operate on the principle of risk-spreading, and the units of these undertakings must be redeemable, directly or indirectly, at the holder's request from those undertakings' assets.[162]

The Directive also outlines certain regulatory provisions that must be included in the laws of member states. Although a UCITS may acquire property essential for its operations, its investments, with few exceptions, must consist exclusively of transferable securities listed on an exchange or dealt in a regulated market in a member state and, if approved by the

151. Peter Gartland, *UCITS Are Running But Hurdles Lie Ahead*, FIN. TIMES, Oct. 14, 1989, at 13.

152. *Money Go Round: What UCITS Are*, *supra* note 17, at 34.

153. UCITS and unit trusts also are known as mutual funds. *Id.*

154. *Id.*

155. *Francke*, *supra* note 143, at 365.

156. *Id.*

157. *See* UCITS Directive, *supra* note 16, at sec. II.

158. *Id.* art. 46, 1985 O.J. (L 375) at 12.

159. "A UCITS may begin to market its units [in another member state] two months after such communication unless the authorities of the Member Sate concerned establish . . . that the arrangements made for the marketing of units do not comply with the provisions referred to in Articles 44(1) and 45." *Id.*

160. *See id.* arts. 2(1), 1-2, 1985 O.J. (L 375) at 4.

161. *Id.* art. 1(2), 1985 O.J. (L 375) at 4.

162. *Id.*

competent authorities, in a nonmember state.[163] Additionally, the UCITS must publicize its issue and redemption prices.[164] Generally, a UCITS may not borrow, except in limited amounts on a temporary basis,[165] may not sell short,[166] and may not lend money or act as a guarantor on behalf of third parties.[167]

The competent authority in a particular member state must be granted all powers necessary to fulfill its duty under the Directive.[168] If a competent authority denies authorization, it must provide reasons therefore to the applicant.[169] Additionally, denial of authorization is subject to judicial review, as is the lack of any decision in excess of six months from the date of application.[170] Only the state of domicile may initiate action against a UCITS for infringement of any law, any regulation or administrative provision, fund rule, or investment company instruments of incorporation.[171]

Although a significant number of funds have gained UCITS authorization, few have yet to take the "cross-border plunge."[172] For example, of the sixty-seven foreign-based funds registered in the United Kingdom, most emanate from Luxembourg.[173] Cross-border activity has remained slow largely because of dissimilar business practices and the continued heterogeneity of the individual EC markets.[174]

One example of the continued heterogeneity may be demonstrated by reference to what constitutes the competent authority in particular member states. In some states, the competent authority is the banking supervisory body, while in others, it is the securities or industry authority.[175] Additionally, distribution methods differ. Although banks are the preferred distribution network in most continental European states, intermediaries and particularly independent intermediaries are the preferred networks in the British and Irish markets.[176]

163. *Id.* art. 19, 1985 O.J. (L 375) at 7.
164. *Id.* art. 34, 1985 O.J. (L 375) at 10.
165. *Id.* art. 36, 1985 O.J. (L 375) at 10.
166. *See id.* art. 40, 1985 O.J. (L 375) at 11.
167. *Id.* art. 41, 1985 O.J. (L 375) at 11.
168. *Id.* art. 49, 1985 O.J. (L 375) at 12.
169. *Id.* art. 51, 1985 O.J. (L 375) at 12.
170. *See id.* arts. 51-52, 1985 O.J. (L 375) at 12-13.
171. *Id.* art. 52, 1985 O.J. (L 375) at 13.
172. *UCITS: An End of Year Review*, *supra* note 149.
173. *Id.*
174. *Id.*
175. *Id.*
176. *Id.*

These variances, coupled with deeply ingrained national preferences, have limited the expected impact of the UCITS Directive on the European mutual fund industry.[177] For example, while the British unit trust industry is heavily biased towards equity investment, the German industry prefers funds that invest in fixed-interest stock issued by the German government and German corporations.[178] Furthermore, the member states lack harmony of taxation practice.[179] Finally, the delay some member states have encountered in implementing the Directive exemplifies the lack of commitment of some member states to the achievement of the UCITS objective.[180]

The UCITS Directive was amended on March 22, 1988 in response to Danish concerns over the limitations article 22 placed on the investment of UCITS assets in transferable securities.[181] Mortgage credit bonds, issued by a comparatively small number of institutions, dominate the Danish market.[182] Thus, the original five percent limit on investment

---

177. Gartland, *supra* note 151, at 13.

178. *Id.*

179. *Id.*

180. *Id.*

181. Council Directive Amending, as Regards the Investment Policies of Certain UCITS, Directive 85/611, 1988 O.J. (L 100) 31. The Amended Directive adds two paragraphs to article 22 of the UCITS Directive, which provide in part:

> 4. Member States may raise the limit laid down in paragraph 1 [5% of an UCITS assets invested in transferable securities issued by the same body] to a maximum of 25% in the case of certain bonds when these are issued by a credit institution which has its registered office in a Member State and is subject by law to special public supervision designed to protect bond-holders. In particular, sums deriving from the issue of these bonds must be invested in conformity with the law in assets which, during the whole period of validity of the bonds, are capable of covering claims attaching to the bonds and which, in the event of failure of the issuer, would be used on a priority basis for the reimbursement of the principal and payment of the accrued interest.
>
> When a UCITS invests more than 5% of its assets in the bonds referred to in the first subparagraph and issued by one issuer, the total value of these investments may not exceed 80% of the value of the asserts [sic] of the UCITS.
>
> . . . .
>
> 5. The transferable securities referred to in paragraphs 3 and 4 shall not be taken into account for the purpose of applying the limit of 40% referred to in paragraph 2.
>
> The limits provided for in paragraphs 1, 2, 3 and 4 may not be combined, and thus investments in transferable securities issued by the same body carried out in accordance with paragraphs 1, 2, 3 and 4 shall under no circumstances exceed in total 35% of the assets of an UCITS.

Id. art. 1, 1988 O.J. (L 100) at 31-32.

182. *See* 1988 O.J. (L 100) pmbl. at 31.

of an UCITS' assets in transferable securities from the same issuer created unique problems for UCITS domiciled in Denmark. The limit posed particular problems when a Danish UCITS sought to invest an appreciable portion of its assets in the domestic bond market.[183]

The EC Council, recognizing that Danish mortgage credit bonds are subject to special rules and supervision which inure to the benefit of the investor and bondholder,[184] increased the allowable investment in transferable securities issued by the same body to twenty-five percent. The amendment essentially allows member states to raise the five percent limit to a maximum of twenty-five percent provided the relevant bonds are issued by a credit institution that is registered in a member state that subjects issuance to special public supervision designed to protect bondholders.[185]

IV. THE 1940 ACT AND THE UCITS DIRECTIVE: A COMPARATIVE ANALYSIS

The SEC has observed that the UCITS Directive, when compared with United States regulation of investment companies, "may be more or less restrictive on any given issue."[186] For example, the UCITS Directive requires regulators in a home state to approve an investment company's manager, rules, and choice of depositary.[187] The UCITS Directive, however, does not directly address other concerns, such as affiliated transactions, pricing, and the use of fund assets for distribution.[188] The United States regulatory scheme on voting and disclosure requirements also differs from the scheme of the UCITS Directive.[189] The UCITS Directive, unlike the Investment Company Act, authorizes the home member state to approve the choice and replacement of a UCITS' management company and depositary and to adopt and amend a UCITS' rules or organizational documents.[190] Under the Investment Company Act, these decisions would be voted on by either the shareholders, directors, or both.[191] Furthermore, although the UCITS Directive does provide for some disclosure, the Investment Company Act and the Securities

183. *See id.*
184. *Id.*
185. *Id.* art. 1, 1988 O.J. (L 100) at 31-32.
186. SEC Release, *supra* note 5, at 25,326.
187. UCITS Directive, *supra* note 16, at art. 4, 1985 O.J. (L 375) at 4-5.
188. SEC Release, *supra* note 5, at 25,326.
189. *Id.* at 25,326 n.28.
190. *Id.*
191. *See* 15 U.S.C. §§ 80a-16, -20, -22.

Act require considerably more disclosure.[192]

Similarly, the UCITS Directive does not provide any fair pricing protection to investors.[193] The 1940 Act, however, requires daily and forward pricing.[194] Unlike the 1940 Act, the Directive does not restrict the affiliations of UCITS' directors, officers, employees, brokers, or underwriters.[195] Finally, the Directive does not prohibit affiliated persons from engaging in transactions with the UCITS.[196]

On November 15, 1988, the SEC presented a policy statement at the annual conference of the International Organization of Securities Commissions (IOSCO) in Melbourne, Australia, identifying areas of regulatory concern raised by rapid internationalization of the securities markets.[197] The statement emphasized the importance of global cooperation among securities regulators in the search for unified solutions to international market problems and suggested bilateral and multilateral agreements for the sale of investment company shares.[198]

The adoption of the UCITS Directive by the EC has thrust IOSCO into a leading role in formulating the future of the international mutual fund industry.[199] With both the SEC and the domestic investment company industry in agreement on the need for change in current law to keep United States companies competitive, the issue then becomes one of form.

The SEC consistently has supported proposals to amend section 7(d).[200] In its 1975 Guidelines, the SEC acknowledged that the differences between domestic and foreign securities laws and regulations might hinder foreign investment company compliance with the 1940 Act.[201] Similarly, the SEC acknowledged that differences in foreign capital markets, securities industry practices, and accounting practices also would

192. SEC Release, *supra* note 5, at 25,326 n.28.

193. *Id.* at 25,326.

194. *Id.*

195. The UCITS Directive does tangentially regulate investment company directors. Unlike the 1940 Act, however, it does not expresly prohibit certain types of affiliations. *Compare* UCITS Directive, *supra* note 16, at art. 4, 1985 O.J. (L 375) at 4-5 *with* 15 U.S.C. § 80a-17. *See also EC Directive Clearing Way to Market Mutual Funds Without Extensive Red Tape*, 22 Sec. Reg. & L. Rep. (BNA) 71 (Jan. 12, 1990) [hereinafter *Directive Clearing Way*].

196. SEC Release, *supra* note 5, at 25,326 n.28.

197. *See Commission Issues Policy Statement on International Securities Regulation*, 20 Sec. Reg. & L. Rep. (BNA) 1753 (Nov. 18, 1988).

198. *Id.* at 1754

199. *Id.*

200. *See* Policy and Guidelines, *supra* note 85, ¶47,661, at 36,610-11.

201. *Id.* ¶47,661, at 36,610-11.

hinder compliance with the 1940 Act.[202] Nevertheless, the SEC has maintained its position that the protections accorded to investors by the legal and regulatory system to which a foreign investment company is subject must closely parallel those provisions of the 1940 Act that the SEC finds applicable to foreign investment companies.[203]

Dramatic developments in the United States and foreign securities markets have increased the role of United States investment companies in the international marketplace. The domestic investment company industry is becoming increasingly receptive to the idea of opening up United States markets to foreign competition to promote reciprocally greater access to markets abroad.[204] As the United States and, ostensibly, the rest of the world embark upon difficult economic times, any regulatory changes affecting the financial industry will have significantly greater impact. Additionally, as securities investing has become more complex, individual investors in the United States have turned increasingly to institutions, particularly investment companies, to manage their investments.[205] Thus, this latest consideration of amendment to the Investment Company Act has the potential to affect the interests not only of a major United States industry, but also of a significant percentage of the United States investing public.

The SEC observed, in its request for comments, that current regulatory, marketing, and fiscal policies in many states disfavor nondomestic investment companies.[206] Registration of a foreign fund in the United States, for example, is so difficult that the SEC recommends the formation of a separate registered United States fund by any foreign investment manager seeking entrance into the United States market.[207]

The SEC acknowledges that the efficient operation of capital markets depends on timely and accurate dissemination of market data.[208] To as-

202. *See id.* ¶47,661, at 36,610.

203. *See* SEC Release, *supra* note 5, at 25,325; *see also SEC Considers Reform of Investment Company Regulation,* FIN. TIMES, Sept. 1990, at 57. The SEC has commented for example that while regulatory methods may differ, "[i]t always will be important to assure that United States investors receive protection from the abuses that the [1940] Act addresses." Shad Letter, *supra* note 77, at 3.

204. *See infra* notes 215-21 and accompanying text.

205. *See supra* note 60 and accompanying text.

206. *See* SEC Release, *supra* note 5, at 25,324-27.

207. Applications of Foreign Investment Companies, *supra* note 74, ¶47,662, at 36,614.

208. United States Securities and Exchange Commission, *Policy Statement: Regulation of International Securities Markets, reprinted in* SEC STAFF REPORT, *supra* note 2, at 607, 609-11.

sist this effort, the SEC suggests that regulators work with the private sector to improve market information systems and make them fully automated "to achieve the goal of worldwide, real-time information dissemination concerning globally traded securities and derivative products."[209] Achievement of this end appears unlikely under the current statutory and regulatory framework existing in the United States. The 1940 Act must be twisted to accommodate many of the current investment vehicles and financial interests, and the respective markets in which they are traded.[210] The SEC's request for comments is partly in response to the recent proliferation of new vehicles, the development of new markets, and the creation of new financial interests that, given the liberal interpretation of "primarily in the business of investing, reinvesting, or trading in securities," and of "the business of investing, reinvesting, owning, holding, or trading in securities," fall within the ambit of the 1940 Act.[211]

Acknowledging that section 7(d) "present[s] unnecessary obstacles to operating foreign investment companies," the SEC has encouraged foreign investment companies to form United States mirror funds.[212] Even if a company is able to assemble a section 7(d) application, the company should expect other parties to file a request for hearing with the SEC. Pursuant to a request, the SEC might conclude that a hearing is necessary because of the issues raised in the hearing petition, the provisions of the 1940 Act, or due process and fairness considerations.[213] The end result is delay in the application process.

---

209. *Id.* at 609-10.

210. *See supra* notes 74-78 and accompanying text.

211. SEC Release, *supra* note 5, at 25,338.

> The Commission, by rules and regulations upon its own motion, or by order upon application, may conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of this subchapter or of any rule or regulation thereunder, if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this subchapter.

15 U.S.C. § 80a-6 (c).

212. Applications of Foreign Investment Companies, *supra* note 74, ¶47,662, at 36,616.

213. The 1940 Act affords "interested persons" the right to make such requests pursuant to SEC notice of an application.

V. THE INDUSTRY RESPONSE TO INTERNATIONALIZATION

The Investment Company Institute (ICI), a United States trade association whose members include investment companies and investment advisers, believes that the UCITS Directive creates an opportunity to negotiate a bilateral treaty with the EC providing for the reciprocal sale of collective investment products.[214] The ICI noted that both its own members and EC member states have expressed interest in a bilateral treaty.[215]

Furthermore, respondents to the SEC's request for comments generally indicate a desire for a regulatory framework conducive to internationalization. One respondent stated that the UCITS Directive exhibited regulatory concerns similar to those under the United States regulatory scheme.[216] This respondent urged the SEC to "recognize that the UCITS Directive generally concentrates its regulatory focus on the same issues that are addressed in the 1940 Act."[217] Another respondent, an indirect, wholly-owned subsidiary of a United Kingdom financial service firm, engaged directly and indirectly in numerous worldwide financial businesses, stated that section 7(d) provided "unnecessary barriers to the introduction of the securities of foreign investment companies into [United States] markets, stifling competition and cutting off [United States] investors from significant investment opportunities."[218] The American Bar Association's Subcommittee on Investment Companies and Investment Advisers of the Committee on Federal Regulation of Securities urged the SEC to foster internationalization "through accommodating interpretations, rulemaking and exemptive orders, consistent with the protection of investors, based upon principles of comity and reciprocity and a territorial approach in the application of the federal securities

---

214. *Directive Clearing Way, supra* note 195, at 71-72; *see also* ICI Comments, *supra* note 78, at 66-67.

215. ICI Comments, *supra* note 78, at 66-67.

216. *See* Davis Polk & Wardwell, Comment Letter to Jonathan G. Katz, Securities and Exchange Commission, Re: Reform of the Regulation of Investment Companies Under the Investment Company Act of 1940, the Investment Advisers Act of 1940, the Securities Act of 1933, and the Securities Exchange Act of 1934, File No. S7-11-90, at 21 (Oct. 10, 1990) [hereinafter Davis Polk & Wardwell Comments]. The comments of Davis Polk & Wardwell reflected the general sentiment of their United States and international clients. *Id.* at 1.

217. *Id.* at 22.

218. James M. Stewart, S.G. Warburg & Co. Inc., Comment Letter to Jonathan G. Katz, Secretary, Securities and Exchange Commission, Re: File No. S7-11-90, at 1, 2 (Oct. 12, 1989).

laws."[219] Another commentator called for amendment to section 7(d) "to permit the registration of a foreign investment company on the basis of international reciprocity in light of the regulatory framework and related circumstances that exist in the foreign investment company's home [state]."[220]

Support for section 7(d) amendment, however, is not universal.[221] For example, one commentator, while recognizing the necessity of accommodating the globalized securities markets and of encouraging "successful international competition," did not "see a need for dramatic structural revisions and [did] not believe that significant regulatory changes [were] necessary to deal with domestic concerns."[222] Despite hesitance toward section 7(d) amendment, this commentator acknowledged that the growth in both size and complexity of the investment company industry since passage of the 1940 Act has far exceeded the SEC's ability "to make appropriate adjustments under the current administrative construction of the adaptive mechanisms fashioned by the [1940] Act's drafters."[223]

The SEC believes that the UCITS Directive may provide foreign regulators with greater discretion to determine whether to permit investment advisers to enter their respective markets.[224] For example, the SEC observes that the minimum standards set out in the UCITS Directive may provide EC regulators with greater latitude, more than even the SEC enjoys, to prevent advisers from entering the investment company business.[225] Nevertheless, the SEC concedes that access by United States

---

219. James H. Cheek, III, Chairman, Committee on Federal Regulation of Securities, American Bar Association, and Thomas R. Smith, Jr., Chairman, Subcommittee on Investment Companies and Investment Advisers, American Bar Association, Comment Letter to Jonathan G. Katz, Secretary, Securities and Exchange Commission, Re: File No. S7-11-90, at 3 (Oct. 18, 1990).

220. Ropes & Gray, Comment Letter to Jonathan G. Katz, Secretary, Securities and Exchange Commission, Re: Investment Company Act Release No. 17534, File No. S7-11-90, at 2 (Oct. 9, 1990).

221. *See, e.g.*, Dechert Price & Rhoads, Investment Practice Group Comment Letter to Jonathan G. Katz, Secretary, Securities and Exchange Commission, Proposed Reform of the Regulation of Investment Companies, Release No. 33-6868, 34-28124, IC-17534, IA-1234, International Series Release No. 128, File No. S7-11-90 at 3 (Oct. 10, 1990).

222. *Id.* at 3.

223. *Id.* at 3-4. Dechert Price & Rhoads noted that the growth in this arena was prompted, "in part, from the enormous changes in the securities markets, including institutionalization and internationalization of these markets and the continuous development of new types of securities." *Id.* at 4.

224. *See* SEC Release, *supra* note 5, at 25,325.

225. *Id.* The SEC Release cites UCITS Directive article 4(3), 1985 O.J. (L 374) at 4-5, which stipulates that a member state may not authorize a UCITS if the directors of the management company and the depositary company are not of "sufficiently good re-

investment companies to European markets might improve with the implementation of the UCITS Directive.[226]

ICI president David Silver has noted that the EC adoption of the UCITS Directive triggered a wave of recent meetings among international mutual fund industry representatives.[227] Since December 1987, three formal meetings have taken place in Frankfurt, Washington, D.C., and Toronto. Attendees have included representatives of the EC, Japan, Canada, and Australia.[228] Most of the representatives take the view that the UCITS Directive may provide a foundation for negotiating agreements between the EC and other states.[229]

This attitude likely will aid the EC effort to achieve a single internal market during 1992. Primary goals include a single financial services market and the removal of all internal barriers within the EC to the free flow of capital and investment.[230] The UCITS Directive is an affirmative step toward the creation of a unitary market.[231]

Generally, the investment company industry has responded favorably to the UCITS Directive, viewing it as a springboard for greater investment opportunities.[232] Similarly, many industry members support section 7(d) amendment to eliminate the barriers to foreign investment companies in the United States.[233] Some commenters have even gone as far as to suggest a revised section 7(d) that would require the negotiation of reciprocal marketing agreements with other states or multinational organizations.[234]

VI. Conclusion

Section 7(d) should be amended to eliminate the barriers to foreign investment companies from nations willing to accord United States investment companies reciprocal treatment. A revised section 7(d) should provide cross-border investment opportunities in accordance with similar regulatory standards. Any amendment must set forth certain minimum

---

pute or lack the experience required for the performance of their duties."

226. SEC Release, *supra* note 5, at 25,326.

227. *See EC Directive on Mutual Funds May Serve as Basis for Global Agreement, ICI Says*, 20 Sec. Reg. & L. Rep. (BNA) 1822, 1822 (Dec. 2, 1988).

228. *Id.*

229. *Id.*

230. 10 International Capital Markets and Securities Regulation § 1.01[2], at 1-8 (Harold S. Blooomenthal ed., 1st ed., 1990 Revision).

231. *See id.* § 1.01[2], at 1-8 to 1-9; § 1.09[2], at 1-163 to 1-171.

232. *See supra* notes 215-21 and accompanying text.

233. *See supra* notes 217-21 and accompanying text.

234. *See, e.g.*, Davis Polk & Wardwell Comments, *supra* note 216, at 21.

regulatory standards and allow foreign investment companies, which are subject to these or similar standards, to market their shares in the United States. The SEC should determine when foreign regulatory schemes protect the same objectives as the United States scheme, albeit via different regulations.[235]

A revised section 7(d), when appropriate, should acknowledge, as the EC White Paper already has done, that "the objectives of national legislation . . . are more often than not identical. It follows that the rules and controls developed to achieve those objectives, although they may take different forms . . . should normally be accorded recognition in all Member States."[236] The SEC has acknowledged that regulatory schemes of other states need not be identical to afford adequate protection of United States investors.[237]

Investor protection, the primary goal for all regulatory schemes, might become a particular concern to United States regulators under this revised scheme. Hence, a revised 1940 Act not only must continue to maintain minimum standards for investor protection, but also must ensure that United States investors have sufficient disclosure and access to a convenient legal forum. An amended 1940 Act might mandate that these kinds of arrangements be included within any reciprocal marketing agreement of investment company offerings. A revised 1940 Act should grant the SEC the authority to enter into reciprocal marketing agreements and thereby maintain the competitive position of the United States investment company industry.[238]

In this vein, the SEC should concentrate on the substantive similarities between United States law and the law of other states, rather than on the technical differences in regulatory implementation. Reciprocal marketing agreements could provide requirements on a state-by-state basis,

---

235. One commentator has suggested that the SEC, in negotiating reciprocal marketing agreements, "should determine whether the foreign regulatory system identifies the same principal concerns and potential abuses regarding investment companies as the 1940 Act, but merely chooses different means to alleviate those concerns and prevent those abuses." Davis Polk & Wardwell Comments, *supra* note 216, at 21.

236. EC White Paper, *supra* note 112, para. 58, at A-21.

237. Specifically, the SEC has stated that "regulatory schemes of other nations may provide protections for investors which serve the same purposes as the protections provided by the [1940] Act, [and that it] could work with foreign investment companies and foreign regulatory authorities to fashion workable regulatory approaches for companies doing business internationally without sacrificing investor protection." Shad Letter, *supra* note 77, at 3.

238. *See* Davis Polk & Wardwell Comments, *supra* note 216, at 21.

in contrast to the current company-by-company basis.[239] Thus, expanded investment opportunities could be controlled by tearing down existing barriers only in instances of comparable United States investment company treatment by a foreign state.

To negotiate these reciprocal marketing agreements effectively, the SEC should be afforded discretion, including the ability to determine when other regulatory schemes protect the same objectives. Because reciprocal marketing arrangements would be made on a state-by-state basis, this change would mean that the SEC actually would enjoy less discretion than it currently enjoys under the ad hoc, company-by-company review process.

The EC's UCITS Directive should serve as a theoretical model for 7(d) amendment. Section 7(d) should be amended to parallel the UCITS Directive and function as a vehicle for expanded global investment opportunities. Just as the UCITS Directive tears down the barriers to cross-border investment within the EC, a revised section 7(d) must tear down the barriers to global cross-border investment with reciprocating states. The international investment community should follow the EC lead and begin to focus on similar regulatory objectives, while recognizing that the implementing rules need not be identical. The necessary amendment of section 7(d), dictated by the current internationalized securities market, should give the United States a primary role in this revised regulatory approach.

*Patrick J. Paul**

239. *Id.*

* The author thanks Rochelle Kauffman, Senior Attorney, Securities and Exchange Commission; Patrick O'Brien, Solicitor, Arthur Cox & Co., Dublin, Ireland; and Dr. Michael Mulreaney, Professor of Public Policy, Institute of Public Administration, Dublin, Ireland, for their invaluable assistance with this Note. The author dedicates this Note to his mother and the memory of his father.