Comment Letter with USTR on Trade Issues, March 1997

March 13, 1997

Frederick L. Montgomery, Chairman
Trade Policy Staff Committee
Office of the United States Trade Representative
600 17th Street, NW
Washington, DC 20508

Dear Chairman Montgomery:

The Investment Company Institute[1] appreciates the opportunity to comment on the issues the Institute and its members recommend be addressed in connection with the negotiation of the terms and conditions of China's accession to the World Trade Organization. Institute members have an interest in obtaining market access to China's domestic asset management industry and the ability to invest more freely in Chinese securities on behalf of their US mutual fund and other clients.

Background

The investment management industry has become a global business. Mutual funds increasingly are the investment of choice for consumers around the world. Total mutual fund assets have grown dramatically in the US from about $716 billion at the end of 1986 to over $3.6 trillion today. Similar growth has occurred throughout the world. Investment company assets outside the US have increased from under $1 trillion in 1988 to $2.5 trillion at the end of 1995. The world-wide growth of mutual fund assets is expected to continue as the number of middle class consumers increases in both developed and developing countries and the baby boom generation enters its peak savings years. While one in three US households owns mutual funds, penetration ratios outside the US are lower. In France and the UK, only one in ten households currently owns mutual funds and penetration ratios are even lower in much of the rest of the world.

In addition, a growing portion of US mutual fund assets is invested abroad. Total assets of international and global equity and bond funds have grown to over $321 billion. New sales of these funds were over $45 billion during 1996.

The US mutual fund industry is a model for the rest of the world. As a result of the strict investment company regulatory regime administered by the US Securities and Exchange Commission, the absence of barriers to entry in the US, and a regulatory and business environment that accommodates innovation in product design and distribution, the US mutual fund industry has earned investor confidence for providing quality investment management services at reasonable cost. The US money management industry would like to be able to take this success abroad by freely marketing its services and products outside the US.

Specifically, Institute members would like to: (1) create affiliates in markets abroad to sponsor and distribute domestic mutual funds in those markets and manage non-US pension assets; and (2) invest freely abroad on behalf of US mutual funds and other US clients.

It is far easier for foreign firms to enter the US market than it is for US firms to market pension and mutual fund services abroad. Foreign investment advisers seeking to do business in the US receive unconditional national treatment. It is easy to register with the SEC as an investment adviser, and, once a foreign firm is registered, it can sponsor and advise US mutual funds and advise non-fund clients, such as US corporate and governmental pension plans. Foreign advisers can offer their services to US clients on a non-resident, cross-border basis, i.e., they do not have to maintain an office and staff in the US. In addition, the SEC has taken steps to facilitate the entry of foreign advisers into the US market.[2] As a result, foreign advisers have entered the US by acquiring existing US firms, by establishing affiliates in the US or by registering with the SEC as non-resident investment advisers.[3]

In contrast, many countries, including China, impose barriers that prevent US money managers from marketing their services and products in those countries. These barriers include laws or regulations limiting foreign firms to holding only a minority interest in a domestic money management firm and arbitrarily high capital or personnel staffing requirements. In addition, many countries restrict the amount of securities of domestic issuers that can be owned by foreigners or impose other difficult conditions on investment, such as advance licensing requirements or restrictions on repatriation of capital.

The goal of the US investment management industry is to obtain market access and the ability to make portfolio investments throughout the world on terms as free as those in the US. The Institute has worked closely with the US government to secure liberalization agreements in important markets.

Market Access

China does not afford foreign money management firms the right to establish wholly owned subsidiaries or affiliates in China to enter the domestic Chinese mutual fund market or provide asset management services to other Chinese clients. In addition, China limits portfolio investment in its market by allowing foreign investors to purchase or hold only "B" shares.

The Chinese mutual fund market consists of 75 funds that were authorized by provincial authorities or the People's Bank of China and its satellite branches. No new funds have been approved since 1993. It has been reported that the PBC will soon put a new system of regulation in place to help develop the industry. The new rules will standardize requirements for the industry and may define the circumstances under which foreign firms can participate in the market.

In the WTO negotiations, China should be asked to commit to permit foreign money management firms to create wholly-owned affiliates in China to organize, sponsor, and advise mutual funds and to provide asset management services to other Chinese clients. If a transition period is needed to achieve this goal, a definite timetable should be specified. Moreover, any transition period should be limited in duration. We are particularly concerned that foreign firms not be limited to holding very small minority interests in management companies for extended periods of time. These types of restrictions provide for the transfer of technology and expertise from the foreign firm to the local company while unfairly preventing the foreign firm from having any meaningful influence over the company. At a minimum, any transition period should permit foreign firms to hold majority interests in management firms within five years.

China also should be asked to remove current restrictions on foreign portfolio investment in China. Investments by US mutual funds represent a benign and stable source of capital to developing markets. Funds do not invest for control and funds and their shareholders take a long-term view of their investments in emerging markets.[4]

Licensing and Registration Requirements

Institute members seeking to do business in China, of course, are willing to submit to local jurisdiction and regulation. We would urge, however, that the requirements for foreign money management firms seeking to provide asset management services in China to mutual funds and other clients take into account the unique nature of the money management business. Rules requiring money management affiliates to have large amounts of capital or staff personnel in China will operate to deny market access to foreign firms.

In distinct contrast to the business of a broker-dealer or bank, creating and managing mutual funds is not a capital intensive business. The assets of a mutual fund are owned by the fund, segregated from the sponsor's assets, and held in safekeeping by specified custodians (typically banks) meeting certain requirements. Mutual fund assets thus are safeguarded for the benefit of shareholders and are not at risk if the mutual fund sponsor experiences financial reverses. Similarly, the business of managing pension accounts does not require large amounts of capital.

Requirements specifying the number of advisory personnel that must be based in the country or limiting the ability of employees to serve other clients also would operate as barriers to entry. Money managers increasingly serve a global marketplace and have a legitimate business need to serve their world-wide clients efficiently and effectively. US-based firms are unwilling to dedicate their most senior personnel to countries with restrictive staffing rules. Thus, not only do these rules create barriers to entry, they prevent local investors from obtaining the services of a money manager's most experienced employees.

Money management firms also should be allowed to provide asset management services to a variety of clients, including mutual funds, pension plans, other institutions, and wealthy individuals. The regulatory system should permit a single firm to be licensed to provide both mutual fund and other investment management services.

Regulatory Transparency and Fairness
The WTO negotiations also should focus on the need for China to develop transparent regulations and licensing requirements and administrative practices that afford a regulated industry with the opportunity to comment on matters affecting the industry. It is particularly important that the regulatory system not limit the number of foreign firms that can participate in the Chinese asset

management market or grant regulators the discretion to exercise subjective judgments in granting licenses.

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We appreciate the opportunity to provide the views of the Institute and its members on the issues that should be addressed in the negotiations over China's accession to the WTO. We would be pleased to provide additional information about our comments at the request of the Trade Policy Staff Committee.

Sincerely,

Mary S. Podesta
Associate Counsel - International

ENDNOTES

[1] The Investment Company Institute is the national association of the American investment company industry. Its membership includes 6,266 open-end investment companies ("mutual funds"), 443 closed-end investment companies, and 10 sponsors of unit investment trusts. Its mutual fund members have assets of about $3.627 trillion, accounting for approximately 95% of total industry assets, and have over 59 million individual shareholders.

[2] See, for example, Unibanco, SEC No-Action Letter (avail. July 28, 1992); Investment Funds Institute of Canada, SEC No-Action Letter (avail. March 4, 1996).

[3] We estimate that the total value of investment company assets in the US managed by foreign investment advisers is $141 billion as of January 31, 1996, or 4.8% of total industry assets. This figure was approximately $70 billion, or 3.3% of total industry assets in September 1994.

[4] See, "US Mutual Funds: Hot Money or Stable Source of Investment Capital?," Perspective, December 1996. This Institute research report, which examined the behavior of shareholders and portfolio managers of US emerging market funds during the 1990s, found that shareholders did not redeem shares in large volumes during periods of market weakness and portfolio managers did not shift investments between countries in a manner that would exacerbate price swings. Instead, funds frequently bought shares when securities prices were falling and sold in rising markets.
