The Asset Management Industry
SERVING INDIVIDUAL INVESTORS

INVESTMENT COMPANY INSTITUTE

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Letter on Transatlantic Economic Partnership Negotiations, September 2000

September 11, 2000

Gloria Blue
Executive Secretary
Trade Policy Staff Committee
Office of the United States Trade Representative
Room 122
600 17th Street, NW
Washington, DC 20508

Dear Ms. Blue:

I am writing on behalf of the Investment Company Institute[1] in response to USTR's request for public comment on general US negotiating objectives for services trade negotiations in the Transatlantic Economic Partnership (TEP). Specifically, you requested comment on the feasibility and desirability of developing mutual recognition agreements or other regulatory cooperation in various service sectors, including private pension fund management.

Background and Summary

The Institute is pleased that pension issues are being given prominence in the TEP discussions. The Institute and its members believe that, with the attention on pension reform around the world, the current round of trade negotiations in the TEP present a historic opportunity for trade negotiators to address market access and other issues in the global pension reform debate.

The Institute supports USTR's efforts to facilitate discussion regarding the efficient regulatory environment for pension fund management. We believe there are regulatory issues that must be addressed in order for Institute members to be able to manage pension assets effectively in Europe. The first part of our letter sets forth the types of regulatory requirements that we believe serve as barriers to market access for US firms seeking to manage pension assets in Europe. Removing these barriers would be in the interest of European pension plans and their participants and beneficiaries. The second part of our letter provides our views on how US negotiators should seek to achieve these objectives.

Pension Management Issues

In this environment of global pension reform, US firms have a strong interest in being able to compete with domestic providers in managing pension assets outside the US. Institute members are interested in opening up the pension markets of individual countries to US firms on commercially meaningful terms. Moreover, Institute members are interested in eliminating requirements that are not necessary for prudential purposes but merely serve to deny effective access to foreign firms in managing pension assets. We discuss these interests, in turn, below.

Market Access

Institute members would like to ensure that countries provide national treatment to foreign firms in managing all pension assets. Our members are interested in competing with local firms on a level playing field.

Specifically, foreign firms should be permitted to provide pension management services either on a commercial presence basis (through wholly-owned affiliates) or on a cross-border basis. Often a foreign firm for business reasons will establish an affiliate in a country to engage in the investment management business. We do not believe, however, that laws and regulations should require a firm to do so. Countries should not prohibit foreign firms from managing pension assets from outside the country if the firms consent

to regulation by the appropriate authorities. Other than the US and Canada, most countries do not permit cross border provision of pension services by investment advisers.

Regulatory Requirements

Institute members seeking to do business abroad are willing to submit to local jurisdiction and regulation. Countries, however, should avoid imposing requirements that do not have an investor protection purpose and operate effectively to keep foreign firms out of the market. These laws not only serve as barriers to entry for foreign firms, but also have an adverse effect on pension fund performance in the countries that impose them.

The following requirements, which are found in many countries, operate as significant barriers to entry into the pension management market.

Domestic Asset Requirements and Foreign Investment Restrictions. Laws that require pension plans to invest in domestic securities and prohibit pension funds from making foreign investments are not necessary for the protection of investors. To cite a few examples: in Austria, at least 40% of the pension assets must be invested in Euro-denominated mortgage bonds, government bonds, and debentures. A maximum of 25% of the pension assets may be invested in foreign securities. In Greece, pension funds may not invest more than 20% of their assets in unit trusts authorized to invest in foreign assets. In Portugal, only 20% of the pension assets can be invested in non-Euro denominated assets.

These restrictions act to prevent US firms from investing for pension clients in markets in which they may have expertise and, therefore, operate as barriers to entry for US firms. They also hinder meaningful pension reform.[2] To maximize returns to pension participants, asset managers should be permitted to invest in a wide range of investments. Countries should eliminate domestic asset requirements and foreign content restrictions and replace them with fiduciary standards based on prudence and diversification.

Excessive Capital Requirements. Rules requiring large amounts of capital are not necessary to manage pension assets. In contrast to the business of a bank or broker-dealer, the business of managing pension assets does not require large amounts of capital to protect investors. Pension fund assets are safeguarded for the benefit of participants of the pension plan and are not at risk if the pension fund manager experiences financial reverses. Many countries currently require asset management firms to meet capital requirements similar to those imposed on banks and broker-dealers. The US has no capital requirements for pension fund managers registered as investment advisers with the SEC. If there are to be capital requirements in other countries, they should, at the very least, be set at appropriate levels and allow a foreign firm to take its parent's capital into account in meeting the requirements.

Residency Requirements. Some countries specify a minimum number of personnel that must be resident in a country or require a firm to organize entirely separate entities and staff to provide investment management services to pension plans and provide other management services. These laws operate to keep foreign firms out of the market. Money managers serve a global marketplace, and personnel should be located where they can best serve their worldwide clients efficiently and effectively. Firms increasingly are centralizing management resources and research systems, which is critical to the success of a global management business.

Anti-Delegation Restrictions. Laws restricting firms from delegating certain functions to their parent company or to affiliates outside the country even if the affiliate submits to regulation and jurisdiction by the appropriate authorities of the host country operate as a barrier to entry. Under these laws, firms are prohibited from delegating the management of a portion of a portfolio to an affiliate that may have a particular expertise. These restrictions on delegation also may prohibit firms from consolidating back office operations designed to achieve economies of scale and cost efficiency. For example, in Germany, all management of an AS pension fund must take place in Germany. A management company is prohibited from delegating management of a portion of a portfolio to an affiliate.

Requirements to Create New Products. Laws restricting the types of mutual funds that can be used as funding vehicles in retirement plans or requiring that entirely new mutual funds be created for these plans operate to keep foreign firms out of a market.[3] These laws disadvantage US firms that want participants to benefit from the economies of scale that they may achieve by offering existing mutual fund products and services to plans.

Mutual Recognition Agreement or Regulatory Cooperation

We believe that the TEP negotiators should seek removal by European authorities of the regulatory barriers described above. We do not believe, however, that the negotiating objectives for pension fund management would be best achieved through a mutual recognition agreement.

Under a mutual recognition agreement, a host country would rely on the regulatory requirements of the home country to permit a firm from the home country to conduct activities in the host country. This arrangement would be based on the principle of "mutual recognition" that the regulatory scheme in one country, although different, would satisfy the requirements of the other country. We

understand that USTR is exploring whether the Employee Retirement Income Security Act of 1974 (ERISA) might serve as a basis for a mutual recognition agreement or other regulatory cooperation with respect to providers of services to pension plans.

Various regulations apply to pension plans and their managers in the US. As you know, there are statutory and regulatory requirements under ERISA, which are administered by the Department of Labor and govern most private sector pension plans created under US law.[4] ERISA and the regulations under it impose minimum standards on the organization and operation of pension plans and require anyone who is a fiduciary with respect to a plan to comply with prescribed fiduciary standards. A non-US pension plan (such as a pension plan in the European Union), however, would not be subject to requirements under ERISA. ERISA does not regulate the provision of pension services or products with respect to non-US plans. Thus, ERISA would not seem to provide a feasible basis for a mutual recognition or regulatory cooperation agreement with the EU with respect to persons providing services to EU pension plans.

We believe that a more effective means to address regulatory issues is to deal with these issues in the context of specific requirements imposed by individual EU countries and requirements that would be imposed in the forthcoming EU Directive on supplemental pensions. We would encourage efforts to be concentrated on persuading the EU and member states to remove requirements in the two areas described above—express market access restrictions and regulatory requirements that operate to deny effective market access.

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We would be happy to discuss these comments with you and to provide any additional information or analysis that you might find helpful.

Sincerely,

Mary S. Podesta
Senior Counsel

cc: Ann Main

ENDNOTES

[1] The Investment Company Institute is the national association of the U.S. investment company industry. Its membership includes 8,239 open-end investment companies ("mutual funds"), 489 closed-end investment companies, and 8 sponsors of unit investment trusts. Its mutual fund members have assets in excess of $7.0 trillion, accounting for approximately 95% of total industry assets, and over 83.5 million individual shareholders.

[2] A report recommending best practices for second pillar pension funds discusses the negative effects of investment restrictions. See Koen DeRyck, "Rebuilding Pensions: Security, Efficiency, Affordability" (published by the European Commission in 1999); Koen DeRyck, "European Pension Funds: Their impact on European Capital Markets and Competitiveness," a report commissioned by the European Federation for Retirement Provision, 1996 (describing the adverse effect of asset allocation restrictions in European countries.)
The adverse effect of asset allocation restrictions on pension plans in Japan was documented in a report sponsored by the Institute, published by the Employee Benefit Research Institute in October 1994, titled "The Impact of Market Access and Investment Restrictions on Japanese Pension Funds." The asset allocation requirements imposed on Japanese pension plans were the subject of negotiation between the US and Japan and in the 1995 US-Japan Financial Services Agreement Japan agreed to remove them.

[3] In Germany, managers must offer entirely separate mutual funds for the AS pension market.

[4] Moreover, advisers to pension funds may be regulated at the federal level by the Securities and Exchange Commission or by the individual states, depending on the assets under management of an adviser. Banks and broker-dealers that provide services or investment products to pension plans are subject to regulation under federal and state banking and securities laws. Insurance companies that provide insurance products are subject to state insurance regulation.

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