SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

January 31, 1984

The Honorable Thomas P. O'Neill, Jr.
The Speaker
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Speaker:

I am pleased to transmit, on behalf of the Securities and Exchange Commission, the attached proposal to amend the Investment Company Act of 1940 to make it easier for the Commission to permit an operating foreign investment company to register under the Act and sell its shares in the United States, when the Commission finds this to be consistent with the purposes of the Act and the protection of investors.

The views expressed in the accompanying materials are those of the Commission and do not necessarily express the views of the President. These materials are being submitted simultaneously to the Office of Management and Budget ("OMB"). We will inform you of any advice received from OMB concerning the relationship of these materials to the program of the Administration.

Sincerely,

John S.R. Shad

Enclosure

cc: James M. Frey
Asst. Director for
Legislative Reference
Office of Management and Budget

MEMORANDUM OF THE SECURITIES AND EXCHANGE COMMISSION IN SUPPORT OF THE FOREIGN INVESTMENT COMPANY AMENDMENTS ACT OF 1984

A. Introduction: Need for Legislation

The Commission is recommending that the Congress amend the Investment Company Act of 1940 (the "Act") to remove unnecessary and anticompetitive barriers to the sale in the United States of the securities of foreign investment companies which primarily invest in securities of non-United States issuers. Currently, Section 7(d) of the Act tends to operate in a way that prevents foreign investment companies from registering under the Act and offering their shares in the United States. The consequences too often are needless costs and insurmountable barriers to foreign companies seeking access to United States markets, lost competitive opportunities, and a denial of investment opportunities for United States investors.

Despite the Commission's publication of guidelines to assist foreign investment companies in meeting the requirements of Section 7(d), the section has too often operated as a practical and legal barrier to foreign companies' gaining access to United States securities markets. That result may not have been particularly troublesome in the past, when the securities markets were predominantly national in character. Today, however, the securities markets are far more international. Investors, living in one country, are increasingly interested in the securities of companies located in other countries. United States securities firms seek opportunities to do business abroad while non-United States owned securities firms are now members of United States securities exchanges. Where possible, United States investment companies are selling their shares abroad to foreign investors. Modern technology and communications systems have made these developments feasible. As competition continues to expand on an international level, national regulatory schemes may need to be adapted to reflect these changes. Conflicts among the regulatory systems of different nations unreasonably impede the natural development of international markets and competition. Section 7(d) currently operates in such a restrictive manner.

Section 7(d): The Current Prohibition On Foreign Investment Companies Selling Shares In The United States

Section 7(d) of the Act currently prohibits foreign investment companies from offering their shares in the United States unless the Commission issues an order permitting them to register under the Act and make such an offering. Under the section, such an order must be based on a finding that "by reason of special circumstances or arrangements, it is both legally and practically feasible effectively to enforce the provisions of [the Act] against such company and that the issuance of such order is otherwise consistent with the public interest and the protection of investors." In 1975, the Commission published an interpretive release ("Guidelines") setting forth its policy and guidelines for filing an application for an order under Section 7(d). The Guidelines included an analysis of the standards foreign investment

companies should meet in order to enable the Commission to make the required findings under Section 7(d).[1]

The Commission recognized in the Guidelines that differences in foreign law and capital markets may make it difficult or impossible for foreign investment companies to comply literally with all the requirements of the Act or with those of Rule 7d-1 under the Act [17 CFR §270.7d-1].[2] Accordingly, the Guidelines indicated that the Commission would, notwithstanding the absence of compliance with all of the provisions of the Act, accept applications for orders pursuant to Section 7(d) and, where necessary, grant exemptive relief from particular provisions of the Act pursuant to Section 6(c) of the Act [15 U.S.C. §80a-6(c)].[3] The Guidelines further stated, however, that any foreign investment company requesting an order under Section 7(d) should, at a minimum, demonstrate: (A) that the protections accorded to investors by the legal and regulatory system under which it operates are substantially equivalent to applicable provisions of the Act; and (B) that, in conformity with standards listed in the Guidelines, it (1) is a bona fide and established company, (2) is subject to actual regulation by an appropriate 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 in the United States, and (6) would provide adequate disclosure in the United States.

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1 Investment Company Act Release No. 8959 (September 2, 1975), 40 F.R. 45424, 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.

2 Rule 7d-1 provides, in general, that a Canadian management investment company may obtain an order pursuant to Section 7(d) if it complies with certain specified conditions and arrangements listed in the rule and designed to ensure the enforceability of the Act against such a company. It also states that "conditions and arrangements proposed by investment companies organized under the laws of other countries will be considered by the Commission in the light of the special circumstances and local laws involved in each case." While the rule addresses Canadian investment companies, it provides a model of the types of conditions and arrangements that should exist for the Commission to make the necessary findings under Section 7(d).

3 Section 6(c) provides that "the Commission. . . 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 [the Act] 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 [the Act]."

Inability of Foreign Investment Companies to Gain Access to United States Securities Markets

The Commission believes that it is important that the Congress amend Section 7(d) to give the Commission greater flexibility to recognize differences in regulatory treatment from nation to nation, and to fashion regulatory approaches for foreign investment companies based on principles of international comity. It always will be important to assure that United States investors receive protection from the abuses that the Act addresses. Nevertheless, the regulatory schemes of other nations may provide protections for investors which serve the same purposes as the protections provided by the Act, and the Commission's staff could work with foreign investment companies and foreign regulatory authorities to fashion workable regulatory approaches for companies doing business internationally without sacrificing investor protection. Unfortunately, Section 7(d) in its current form presents difficult barriers to the development of workable solutions to the problems of international securities markets for investment companies. Because they operate under different cultural and legal systems, foreign investment companies sometimes must comply with laws that conflict with the Act's requirements or must be structured differently from United States investment companies. The Commission's experience has demonstrated that a foreign investment company may in fact need extensive exemptive relief from the Act in order to function in a manner consistent with its own domestic laws and business practices. For example, exemptions may be necessary to reconcile the Act's corporate governance provisions, which are based on a concept of disinterested directors, with foreign law, which may not contemplate such a concept.[4] While United States law certainly should not and would not always bend to the requirements and values of foreign laws, Section 7(d) affords the Commission little opportunity to seek reasonable accommodations since it requires a finding that the Act will be legally and practically enforceable against the foreign company. Where foreign regulatory systems would provide investor protections which serve the same purposes as those provided by the provisions of the Act from which exemption is requested, the Commission believes it should have greater flexibility to fashion rules and orders to permit foreign investment companies subject to those regulatory systems to sell their shares in the United States.

As noted above, the Commission believes that Section 7(d) creates unwarranted difficulties for a foreign investment company which desires to sell its shares in the United States. It seems likely that these companies will continue to submit applications to the Commission, but because the companies operate in legal or regulatory environments different from the Act, the requisite statutory findings will be difficult or impossible to make. Therefore, the Commission is recommending legislation to amend Section 7(d) of the Act in order to permit a foreign investment company to offer its shares in the United States, even if it would not be literally possible to enforce all the provisions of the Act against that company, provided that arrangements exist which would protect investors satisfactorily.

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[4] See e.g., Section 10(a) of the Act [15 U.S.C. §80a-10(a)], which requires that at least 40 percent of an investment company's board of directors be persons who are not "interested persons" of the company as that term is defined in Section 2(a)(19) of the Act [15 U.S.C. §80a-2(a)-19)]; and Section 15(c) of the Act [15 U.S.C. §80a-15(c)], which requires that any underwriting or investment advisory agreement entered into by an investment company must be approved by a majority of its directors who are not parties to the agreement or "interested persons" of any party.

B. The Commission Proposal

The Commission's proposed amendment to Section 7(d) will facilitate access to U.S. securities markets by responsible foreign investment companies primarily engaged in investing in securities of non-United States issuers when such companies are subject to laws of foreign countries which provide protections which serve the same purposes as those provided by the provisions of the Act from which exemption is requested.

As described above, Section 7(d) currently requires a Commission finding that it is both legally and practically feasible to enforce the provisions of the Act against a foreign company interested in registering under the Act and making a public offering of its securities by use of the mails or other means of interstate commerce. Under the proposed amendments to Section 7(d), the Commission would be authorized to grant exemptions with respect to an operating foreign investment company from those provisions of the Act with which the Commission finds compliance to be unduly burdensome, given the nature of the company. The Commission also must find either that the laws under which the company operates provide protections for investors which serve the same purposes as the protections provided by the provisions of the Act from which exemption is requested or that specific conditions agreed to by the company provide such protections. Such protections would not have to be the same as those provided by the provisions from which exemption is requested, but would have to have the same purposes. In addition, the Commission would have to find that an exemption is consistent with the protection of investors and the purposes fairly intended by the policy of the Act and that the company is not operated for the purpose of evading the provisions of the Act.

An operating foreign investment company would be defined as a company organized or created under the laws of a foreign country which has been in operation, with a minimum of 500 non-United States shareholders and $100 million in net assets, for a period of three years or more, and which is primarily engaged in investing in securities of non-United States issuers. The Act, as amended, would allow the Commission to permit an operating foreign investment company to register under the Act and make a public offering of its securities in the United States upon finding that it is possible to enforce against the company those provisions of the Act from which exemption has not been granted.

Under the amended Section 7(d), the Commission would be authorized to revoke or modify any order issued under the subsection with respect to an investment company organized or otherwise created under the laws of a foreign country if it finds that (1) it is not legally and practically feasible effectively to enforce the provisions of the Act, to which such a company is subject, against the company, or that (2) a company exempted from any provision of the Act as an operating foreign investment company is not primarily engaged in investing in securities of non-United States issuers, or that (3) the laws under which an operating foreign investment company operates do not provide investor protections which have the same purposes as those provided by the sections of the 1940 Act from which exemption has been granted or that specific conditions agreed to by the company do not provide such investor protections.

The Commission's proposal would provide the Commission with much-needed flexibility for the development of rules and orders permitting registration of foreign investment companies without sacrificing investor protection.

C. Conclusion

The Commission believes that enactment of the Foreign Investment Company Amendments Act of 1984 would recognize the increasingly international character of the securities markets and give the Commission necessary authority to fashion regulatory requirements that will protect investors while permitting them to invest in operating foreign investment companies. The legislation will modify the stringent "enforceability" standard of Section 7(d) with a more flexible standard. For the foregoing reasons, the Commission strongly urges that Congress enact the Foreign Investment Company Amendments Act of 1984.

A BILL

To amend the Investment Company Act of 1940.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Section 1. That this Act may be cited as "The Foreign Investment Company Amendments Act of 1984."

Section 2. Section 7(d) of the Investment Company Act of 1940 (15 U.S.C. 80a-7(d)) is amended by adding at the end thereof the following:

> :Provided, however, that with respect to an operating foreign investment company, the Commission may by rule or order grant exemption from any provision of this title if it finds that (1) compliance with such provision would be unduly burdensome because the company is organized or otherwise created under foreign law and invests primarily in foreign securities, (2) the laws under which such company operates provide protections for investors which serve the same purposes as the protections provided by the provisions of this title from which exemption is requested or that specific conditions agreed to by the company provide such investor protections, (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.
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> The Commission, upon its own motion or upon application, may by order revoke or modify any order issued under this subsection with respect to an investment company organized or otherwise created under the laws of a foreign country whenever it shall find that (1) it is not legally and practically feasible

effectively to enforce the provisions of this title, to which such a company is subject, against the company, (2) a company exempted from any provision of this title as an operating foreign investment company is not primarily engaged in investing in securities of non-United States issuers, or (3) the laws under which an operating foreign investment company operates do not provide investor protections which have the same purposes as the protections provided by the provisions of this title from which exemption has been granted or that specific conditions agreed to by the company do not provide such investor protections.

Section 3. The amendments made by this Act shall become effective upon enactment.

SECTION-BY-SECTION ANALYSIS

SECTION 1. The Act may be cited as "The Foreign Investment Company Amendments Act of 1984."

SECTION 2. Section 7(d) of the Investment Company Act of 1940 ("1940 Act") currently prohibits an investment company organized or otherwise created under the laws of a foreign country from registering under the 1940 Act and making a public offering of its securities by use of the mails and means of instrumentalities of interstate commerce unless the Commission finds that, by reason of special circumstances or arrangements, it is both legally and practically feasible effectively to enforce the provisions of the 1940 Act against such company and that the issuance of an order permitting such registration and offering is otherwise consistent with the public interest and the protection of investors.

The Act amends Section 7(d) to authorize the Commission, with respect to an operating foreign investment company, to grant, by rule or order, exemption from any provision of the 1940 Act if the Commission makes the following findings: (1) by reason of the company being an operating foreign investment company (as that term is defined in the Act), compliance with the provision would be unduly burdensome, (2) either the laws under which the company operates provide protections for investors which serve the same purposes as the protections provided by the provisions of the 1940 Act from which exemption is requested or specific conditions agreed to by the company provide such investor protections, (3) an exemption is consistent with the protection of investors and the purposes fairly intended by the policy of the 1940 Act, and (4) the company is not operated for the purpose of evading the provisions of the 1940 Act.

An operating foreign investment company is defined, for purposes of Section 7(d) of the 1940 Act, as a company which (i) was organized or created under the laws of a foreign country, (ii) has had a minimum of 500 non-United States shareholders and $100 million in net assets at all times during the three year period immediately preceding the filing of an application for registration under the 1940 Act, and (iii) is primarily engaged in investing in securities of non-United States issuers.

Thus, the Act will enable the Commission to permit an operating foreign investment company to register under the 1940 Act and offer to sell its securities in the United States markets if the Commission finds that it is both legally and practically feasible effectively to enforce against such company those provisions of the 1940 Act from which exemptions have not been granted.

In addition, under the amended Section 7(d), the Commission would be authorized to revoke or modify any order issued under the subsection with respect to any investment company organized or otherwise created under the laws of a foreign country if it finds that (1) it is not legally and practically feasible effectively to enforce the provisions of the 1940 Act, to which such a company is subject, against the company, or that (2) a company exempted from any provision of the 1940 Act as an operating foreign investment company is not primarily engaged

in investing in securities of non-United States issuers, or that (3) the laws under which an operating foreign investment company operates do not provide investor protections which have the same purposes as those provided by the sections of the 1940 Act from which exemption has been granted or that specific conditions agreed to by the company do not provide such investor protections.

Section 3. The Act is to become effective upon enactment.