OECD

Organisation for Economic Co-operation and Development

Publication sponsored by the Japanese Government

INSURANCE AND PRIVATE PENSIONS COMPENDIUM FOR EMERGING ECONOMIES

Book 2
Part 1:4)a

CORPORATE GOVERNANCE AND COLLECTIVE INVESTMENT INSTRUMENTS

John Thompson

2001

This report is part of the OECD Insurance and Private Pensions Compendium, available on the OECD Web site at www.oecd.org/daf/insurance-pensions/ The Compendium brings together a wide range of policy issues, comparative surveys and reports on insurance and private pensions activities. Book 1 deals with insurance issues and Book 2 is devoted to Private Pensions. The Compendium seeks to facilitate an exchange of experience on market developments and promote "best practices" in the regulation and supervision of insurance and private pensions activities in emerging economies.
The views expressed in these documents do not necessarily reflect those of the OECD, or the governments of its Members or non-Member economies.

Insurance and Private Pensions Unit
Financial Affairs Division
Directorate for Financial, Fiscal and Enterprise Affairs

TABLE OF CONTENTS

I. Introduction: Long-term Trends and Prospects in the CIS Sector

Over the past decade, the collective investment sector has proven to be one of the fastest growing components of the financial systems of OECD countries. OECD data indicate that the assets of collective investment schemes (CIS) in the sixteen OECD countries that comprise the bulk of the sector rose from $2.6 trillion equivalent in 1990 to $9.3 trillion in 1998 (see Table 1). Preliminary data suggest that the trend continued into 2000. This extraordinary growth reflected a number of trends:

- Since the early 1980s, financial intermediation has been shifting away from banks to securities markets while bond and equity markets in most OECD countries have been producing very attractive returns. CIS have been the main avenue for small inventors to take advantage of the resulting opportunities.

- Along with spontaneous changes in capital markets, many governments have taken measures to bolster the legal and regulatory framework for CIS. In countries where the legal and regulatory system for CIS was already well developed (*e.g.* the United States and France), change tended to be incremental. However, changes were more fundamental in some countries in Europe where restrictions on the permissible range of CIS had been maintained and in countries where there was no special law governing the CIS sector. In addition to the domestically initiated reforms in CIS laws and regulations, the CIS sector in Europe received a potent stimulus from the European Commission's UCITS Directive of 1985. Japan and Korea introduced major reforms in the past three years, but these changes have not yet resulted in major changes in the CIS sector in these countries.

- Major financial institutions have targeted asset gathering and investment management for retail clients as a major growth area and are seeking to develop products that offer a broad range of investment choice to individuals. Rising demand for longer-term investment products has been accentuated by the necessity to build private savings in order to assure adequate retirement income.

The CIS sector has grown in a broad range of countries at various stages of capital market development. In the United States, where the capital market and the mutual fund industry were both well developed at the beginning of the 1990s, the assets of open-ended investment companies (*i.e.* mutual funds) tripled as a share of GDP between 1990 and 1998 (see Table 2). The mutual fund industry developed an increasingly diverse range of investment options, including sectoral funds, index funds, emerging market funds, and asset allocation funds. While most funds were originally produced and distributed by full service brokers, diversification of distribution channels characterised the industry. Discount brokers, "fund supermarkets", insurance agents, independent financial planners and direct sales by mutual fund companies have all become significant distribution channels. Banks, who had previously been banned from CIS business, made major inroads. Partly due to the growth of defined contribution pension plans, by the end of the 1990s almost half of the assets of the CIS industry were held in tax deferred products.

In Europe, expansion was even more rapid than in the United States, albeit from a lower base since many European countries did not have well-developed CIS sectors in the early 1990s. In this connection, there was a noticeable shift in asset preferences towards CIS in countries where collective investment instruments had been rudimentary. For example, in Spain the assets of CIS rose from only 3 per cent of GDP in 1990 to 44 per cent in 1998.

The CIS industry in Europe achieved significant integration, partly because of the European Commission's Directive on Undertakings on Collective Investments in Transferable Securities (UCITS) of 1985 that set standards for CIS, making it possible for CIS meeting the requirements of the Directive to be marketed throughout Europe. Many CIS were formed in international fund management centres, particularly Luxembourg – and more recently Dublin. Due to the favourable legal and tax regimes, CIS formed under the laws of these centres were able to meet UCITS specifications and thus were eligible for sale throughout Europe. Major financial institutions operating from these centres have distributed funds throughout Europe along with their domestically domiciled funds, which often had only limited marketability. Funds domiciled in these centres account for a very large share of holdings of CIS by residents in several European countries. The United Kingdom remained a major centre for funds management although many of the funds managed there are domiciled in other jurisdictions. Due to the growing internationalisation of the European industry, a considerable convergence in products has occurred. One further sign of internationalisation is that European CIS portfolios tend to contain a higher proportion of foreign securities than their American counterparts.

In both the United States and Europe there was a movement away from money market funds toward bond and equity funds. Strides toward developing an "equity culture" were visible in several European countries that previously had rudimentary securities market and a strong preference for "low risk" debt instruments.

Not all OECD countries participated in the growth of the CIS sector. In Japan and Korea the CIS sector tended to contract as a share of GDP in the 1990s, apparently due to the weaknesses in their domestic equities markets as well as the lack of appropriate market infrastructure. Additionally, the industry did not show great dynamism in Denmark, Norway, Finland, Turkey, New Zealand or Mexico where the share of CIS in GDP was low and/or did not advance.

Looking ahead, the forces that encouraged expansion in the 1990s, such as increasing use of capital markets and continuing attempts to develop investment products to attract the savings of retail investors are expected to underpin future growth. CIS should benefit from the growing desire to supplement public pensions with private savings. Many countries are considering the introduction or expansion of funded pension schemes and CIS are potentially well suited for such programmes.

Technology will continue to have a major impact. The Internet has already proven to be a highly effective information channel for the CIS sector as well as an important distribution channel. As investors become more sophisticated and obtain better access to information, market conditions should become more competitive, with greater diversification among distribution channels, an increasing variety of products and some downward pressure on charges.

Ownership relations and strategic alliances among originators and distributors will become more flexible. A number of major institutions have begun marketing products originated by other asset management companies. Discount brokers and fund supermarkets have established footholds in several countries. In some countries, such as the United Kingdom and Australia, independent financial advisers (IFAs), who provide financial advice for fees while marketing products from a number of firms, already constitute a major channel of distribution and similar systems may spread to other countries as well. In Japan and Korea major structural reforms of the CIS industry have been launched, and in both countries strategic alliances between local financial institutions and foreign asset managers have been developed that will link the distribution networks of the local institution with the fund management skills of foreign institutions. More generally, many strategic planners in the CIS industry predict the emergence of "open architecture" where the services in CIS products will be unbundled and CIS operators will design funds that may be distributed by a variety of financial and non financial enterprises.

The availability of information to investors has been a major force driving the growth of the CIS sector. The first element in the flow of information is mandatory disclosure. However, a growing network of information-processing firms enhances the value of this information by regularly obtaining data from collective investment firms, presenting the data in a consistent way, comparing the performance of various CIS and disseminating the results. Some information services also rate funds by their performance with respect to peer groups or the fund's return in relation to the risks it has assumed. Initially, the information was mainly available to analysts in financial intermediaries or through IFAs while the general public had access through the specialised financial press. The Internet has made such information easily accessible to the mass market. Clearly, access to information narrows the information advantage of fund promoters over investors.

The combination of advances in technology and financial innovation together with problems related to CIS costs and investment strategy may induce investors to turn to alternative investment products. Closed-end investment funds, which issue a limited number of shares and trade on exchanges, have experienced significant growth in some markets. These funds tend to have lower operating costs, are especially suited to operating in markets for illiquid securities and have an enhanced capability to use leverage. On the other hand, they tend to trade at discounts to NAV. Some recent technology-induced innovations are exchange-traded indices which allow the investor to trade an index throughout the trading day, while pushing trading and management costs to exceedingly low levels. Other innovations include customised investment baskets in which investors can create their own tailor-made portfolios, with desired risk characteristics and which enable investors to re-configure their portfolios at will. These products are now mostly used by sophisticated investors, but financial innovation may permit the development of products tailored to smaller and less sophisticated investors.

II. Agency Problems in the CIS Sector: The Challenge of Governance

The principle underlying the collective investment industry is rather straightforward. While many investment opportunities are available in the capital market, most individuals lack the requisite investment skill and cannot afford sufficiently diversified portfolios or execute large trades. CIS offer individuals a means of pooling their funds and hiring professionals to manage their investments. Whatever the legal structure, a CIS can be thought of consisting of three elements: 1) a pooling of resources to gain sufficient size for portfolio diversification and cost-efficient trading; 2) a set of safeguards to ensure that the promoters of the CIS do not take advantage of the investor; and, 3) professional portfolio management.

In its broadest sense, the task of governance of CIS can be conceived of a set of arrangements, including a well-defined legal and regulatory framework for investor protection, through which a fund operator offers the public a vehicle embodying a specified investment mandate, communicates essential facts about the CIS to investors and implements the investment strategy on an ongoing basis.

Some of the main participants in the process of collective investment are:

- The investors, who entrust their savings to the CIS.
- The operator or investment manager, who is responsible for the functioning of the fund and formulates and executes the investment strategy. Final responsibility for operating the fund in accord with the laws and regulations of the jurisdiction and the rules of the fund usually lies with the operator of the fund.
- The custodian or depository, who holds the assets and performs some monitoring functions.

Other participants may enter the process. The operator may delegate responsibility for investment advice to an investment adviser who may have expertise in a particular market sector (*e.g.* Asian equities, mortgage-backed securities or pharmaceutical companies.) In all countries, the operator retains responsibility for the CIS vis-à-vis the investor even if some functions are delegated to other entities.

A few CIS are offered by companies that specialise in CIS management. Most, however, are affiliated with other financial organisations, such as banks, securities houses, or insurance companies. CIS services are usually provided through a specialised investment management company, which is often a subsidiary inside a financial group. In some cases the law requires the formation of a specialised investment management company. Even where it is not legally required, a separate investment management company is the most common form of organisation in CIS business. The parent company of the investment management company will often act as distributor using its own marketing system, such as a bank branch network or insurance sales force, to market its own "proprietary" CIS. Often the reputation of the parent company is important in marketing the CIS. Alternatively, it may distribute CIS from other asset management companies. The sales fees generated by the distribution network can be a significant source of revenue for the parent.

The CIS sector is characterised by complex agency relationships and asymmetry in market power and information. The risk is present that some participants in the collective investment process will abuse agency relationships. In the simplest case, without proper safeguards, operators of a CIS could misrepresent the assets in the portfolio or the value of the portfolio or make false representations concerning the investment strategy that will be followed or the risks involved. There are instances where such problems arose owing in part to the absence of adequate investor protection frameworks.

In addition to outright fraud, there is the risk of conflict of interest. Even if investment management companies had no ownership linkages to other financial institutions, CIS operators might manage assets in their own interest rather than the investors. The manager might charge the highest possible fees for services. He might also seek to attract as many investors into the fund, even if this should result in the fund becoming too large for efficient asset management. In executing the investment strategy, the investment manager might take excessive risk or may hold a portfolio that is nearly identical to the benchmark index in order to avoid under-performing the index. These cases are likely to be less clear cut than those involving fraud.

Potential conflicts are even greater in practice since most CIS are affiliated with other financial institutions. Even in cases where the CIS is legally a freestanding legal entity, such as a corporation or a trust, all of the facilities of the fund belong to the asset management company and all managers of the fund are employed and compensated by the asset management company.

The abuse of agency relationships could occur in many ways. The managers of the fund could use the fund to support issues of securities underwritten by the parent organisation. In extreme cases these funds can be used to purchase assets that could not be placed in a public offering. The fund managers could also direct securities trades to affiliated market intermediaries, rather than seeking best execution of orders. There is also the risk that the company will trade excessively in order to increase the commission income of affiliated market intermediaries (churning of portfolios). Failure to withhold information about possible trades from affiliated intermediaries can allow these intermediaries to "front run". In all of these cases, the operator could trade at prices or commissions that are inappropriate from the point of view of investors while allowing the operator or the affiliated intermediary to earn profits from an inside relationship. Since costs are directly incurred by the investment management company, which operates a large number of funds and often shares facilities with other members of the financial group, equitable ways must be found to allocate expenses among CIS.

In order to address such conflicts of interests, OECD countries have created well-defined legal and regulatory environments for CIS. Efforts on the official side are supplemented by practices of firms and industry groupings to improve standards and enforcement mechanisms. Robust investor protection systems involve the elaboration of acceptable principles, rules and practices, and the development of institutional structures by which standards are enforced.

III. Development of International Standards

A. Early Development of International Standards: OECD, EC and IOSCO

OECD member countries have been perfecting standards within national financial systems sector for decades. At the same time, there has been considerable sharing of experience among countries and articulation of common standards. Between the early 1970s and the early 1990s, three major international efforts to develop standards deserve some comment:

- In 1971, the OECD Committee on Financial Markets issued "Standard Rules for the Operations of Institutions for Collective Investment in Securities" [1]. It is worth recalling that at that time, the CIS sector was rather insignificant in many countries. Some countries did not have any laws covering CIS. Highly publicised instances of fraudulent marketing had arisen in several European countries, with some legislatures threatening to enact highly restrictive laws. Since no other international body was well placed to take the lead in developing international standards, the CMF produced a basic set of standards to assist countries in eliminating basic deficiencies.

- In 1985, the EC Council approved the UCITS Directive. Like the OECD principles, the EC effort aimed to raise standards and also aimed to promote cross border business in CIS among EC members by achieving greater uniformity of practice. The Directive continues to be in force, and any CIS that meets the criteria specified in the UCITS Directive is potentially eligible for distribution throughout the EC. However, approval for distribution is not automatic. Any fund has to be registered with the authorities of any country in which it is distributed.

- In 1994 IOSCO issued its Principles for the Regulation of CIS. This initial statement of basic principles launched an ongoing effort by IOSCO to promote standards in the CIS sector.

Annex 1 summarises the main points of the three early statements of principles and standards. There is great similarity in these early statements concerning standards. The UCITS Directive imposes an obligation on a UCITS manager to operate solely in the interests of unit holders; the OECD and IOSCO principles mention the duty of the operators of the CIS to act in the interest of the investors and that means must be found to adjudicate conflicts of interest between the investors and the operator.

All three statements stipulate that supervision must be adequate to assure that the laws, regulations and industry practices are observed and the operator acts in accord with stated objectives, and that the regulator must have adequate means to investigate actions and the power to carry out supervisory functions. The supervisor should assume responsibility for licensing operators and investigate each product offered.

All three specify that rules must be set specifying that the assets of the CIS will be held by a custodian in a way that satisfies the supervisors that the CIS assets are accurately represented. While the OECD Standard

---

52. Report by the Committee on Financial Markets of February 1972 [C (71) 234]. This document was approved as a set of Council Recommendations.

Rules allow the regulatory authorities to approve several arrangements for custodians, the IOSCO principles specifically state that the custodian must be independent of the CIS operator. The UCITS Directive goes beyond requiring a custodian and instead requires a depository having specific responsibilities for ensuring that the fund is run in accordance with the relevant rules.

The principle that the operator must be willing to redeem shares at NAV upon request of the investor is affirmed in all cases. The CIS is obliged to explain the principles of pricing and valuation that are used in calculating NAV and the supervisor must approve these principles. All sets of standards also indicate that CIS should have limits on concentration and portfolio diversification and all address borrowing, short sales and maintenance of liquidity. The IOSCO Principles specify that assets must be valued at market prices.

Disclosure is an important element in all sets of standards. Disclosure requirements cover the legal structure and governance procedures of the fund. Persons and companies fulfilling certain key roles (investment manager, advisement adviser, trustee, custodian, director, distributor etc.) must be identified. Disclosure requirements usually also encompass investment objectives and performance, portfolio holdings, fees, commissions and expenses. Rules governing redemption must be stated. The fund must also disclose particular risks being assumed. Policies concerning the use of leverage and derivatives must also be explained. In all sets of principles it is stipulated that CIS should issue prospectuses and the type of information that must be in prospectuses is explained. The CIS should publish annual and semi-annual reports that discuss portfolio holdings, performance and activities. The obligation to avoid misleading assertions when advertising and the responsibility of the supervisor to prevent false or misleading advertising are made explicit.

B. Further work by IOSCO

Following the initial statements of its principles of regulation in 1994, IOSCO's WP5 continued to produce more refined sets of standards. Key points in these standards are summarised in Annex II. Subsequent work elaborated on principles already stated in earlier work or sometimes broached new questions. For example, progressively detailed guidelines were developed on pricing and valuation.

The issue of conflicts of interest, which was first broached in the 1994 principles, has been further elaborated in other IOSCO work. The 1997 Principles for the Supervision of CIS Operators provided more detailed definitions of conflicts of interest including principal transactions between the operator and affiliated companies, such as principal transactions and joint participation between the operator and affiliated companies, soft commissions, lending and borrowing among affiliates, purchases of securities underwritten by affiliates and use of affiliated brokers. Specific ways in which the regulatory authority could take action to assure that any such activities are in the interest of investors and to sanction violations were identified. The 1997 Principles also mentioned the duty of the CIS to monitor and disclose connected party transactions and to develop protective arrangements when a CIS operator is affiliated with a company engaged in other activities. The definition of conflicts of interest was sharpened with the identification of excessive trading (*i.e.* churning) and cash commission rebates.

In May 2000, WP5 produced an additional paper elaborating on the notion of conflicts of interest. The development of increasingly detailed lists of possible conflicts of interest has been instrumental in focusing the attention of industry participants and regulators on mechanisms to devise guidelines for dealing with potential abuses**.**

C. Work by the EU

There have been several rounds of discussions concerning the UCITS Directive since 1985. At the time the UCITS Directive was introduced, many European countries had severe restrictions on the type of product that could be introduced that were reflected in the Directive. The UCITS Directive for example does not recognise "fund of fund" or real estate funds, which are common forms of CIS in Europe. Subsequently, countries have generally broadened the range of permissible products, but the UCITS Directive has remained unchanged. In May 2000, two important modifications to the UCITS Directive were proposed.

The first change would broaden the definition of instruments in which UCITS may invest to include bank deposits, money market instruments, financial derivatives and units of other CIS (funds of funds). Investment management techniques such as index tracking and securities lending would also be recognised.

The second proposed change would focus on the investment manager and harmonise rules for firms that may be recognised as investment managers. This would give rise to a "European passport" under which any firm authorised as an investment manager in any EU state would be able to operate in all EU members. The Directive would also allow any those companies authorised to perform investment management for individuals through CIS to engage in investment management for private clients and for institutional investors.

IV. Investor Protection and Governance Systems of CIS

The purpose of this section is to consider the internal systems to ensure investor protection in CIS in order to make it possible to arrive at a broad characterisation of the internal governance systems in Member countries. It has been seen that there is considerable agreement among CIS supervisory authorities on basic standards of investor protection. However, each operator must formulate and implement institutional procedures to enforce those standards. The internal oversight procedure consists of two parts: the internal compliance processes of the CIS and review by designated independent parties within the CIS structure.

A. Internal Compliance and Audit Procedures

Whatever the legal regime, the decision-making centre of all CIS is the investment management company (usually identical to the operator). In all systems the investment management company is expected to have significant independence from affiliated companies and to operate the CIS in the interest of investors. Means to achieve this independence include the formation of a separate investment management companies with their own boards of directors having final responsibility for all CIS under their management. Most initiatives regarding the creation of new funds, the design and execution of investment policies and other strategic issues in the CIS (fees, marketing strategies etc.) lie with the investment management company and its directors. The investment management company also has responsibility for the design and implementation of policies and practices to monitor compliance with laws, regulations and to be sure that actual investment policies are consistent with those laid down in the fund prospectus. The investment management company must also have systems in place to ensure its independence from affiliated companies inside the financial group.

One of the key elements in building a robust system is the internal compliance function. The compliance function is charged with ensuring that prudential standards are met. In many countries it is specifically required that the operator establishes written procedures describing policies that are subject to review by the supervisory authority. The compliance department will often be the main point for contact with the

regulator on an ongoing basis. Further it is the responsibility of the regulator to verify that the CIS has established adequate means to carry out that task and to license only those operators who can comply with this requirement.

The IOSCO questionnaire on "Decision Making Structures in CIS" of May 2000 surveyed practices in 16 major jurisdictions. The OECD Secretariat broadened this enquiry to other member countries and undertook additional fact finding. Based upon this evidence, the role of the compliance function appears broadly similar in Member countries (See Annex III.). Some countries' regulations require the naming of a compliance officer and/or the elaboration of a compliance plan. Sometimes, it is required that the compliance function be separated from the management structure of the CIS operator and report directly to the board of directors of the fund, the investment manager or to the trustee. Sometimes, the regulations stipulate in detail the requirements for monitoring. In other cases, the regulation simply states that CIS operators must have adequate systems to comply with relevant rules and policies while industry best practice determines the actual structure of surveillance. Even if the regulatory regime does not mandate an independent compliance function and the task is left to the CIS operator, the operator retains full accountability for all infractions. In most countries, it is permissible for the asset management company and the parent company to have a common compliance department. (However, Canada requires a separate compliance department at the CIS level.) All countries require an internal auditor to monitor the reports and statements of the CIS.

B. Internal governance mechanisms

So far it has been seen that investor protection standards and internal compliance functions are broadly similar in OECD countries. In addition to the compliance function, all systems have erected "internal control systems" in which final responsibility for oversight is located. It is at this point that Member country practice begins to diverge. Each system has defined a role for an outside party to exercise an oversight function over the operator of the CIS and the agents of the operator to be sure that standards are observed. However, the specific entities charged with independent oversight and their specific responsibilities differ among countries. The entity responsible for review of operations are a) the directors of the mutual fund in the United States system, the b) trustees in a trust system and c) the depository in most European systems, regardless of legal structure. Those designated parties that exercise the oversight function are expected to be have some degree of independence of the operator and to exercise their duties in the interests of the final investors, independently of other relationships.

C. Legal Structure

The objective of allowing the setting up of schemes that enable investors to participate in a pool of professionally managed assets for a designated investment objective is common to all countries. However, countries have adopted various legal forms to achieve this aim.

There are three basic legal structures for CIS in OECD countries:

- In the corporate form, the CIS is a separate corporate entity in which the assets are owned by the investment company and the investors are shareholders of the investment company.

- Under the trust form, the CIS is organised as a "trust," a concept of Anglo-Saxon law in which an identified group of assets is constituted and managed by trustees for the benefit of another party (the beneficiary). The investor is a beneficiary of the trust and owns units of the trust.

- In the contractual form, the investor enters into a contract with an investment management company, which agrees to purchase a portfolio of securities and manage those securities on behalf of final investor. The investor owns a proportional share of the portfolio.

The laws of some countries allow for only one legal form for collective investments, while others allow for more than one. Thus, the United States and Mexico only recognise the corporate form. Several countries, (*e.g.* Belgium, Czech Republic, France, Greece, Italy, Luxembourg, Spain and Turkey) have both corporate and contractual forms while Denmark, Germany, Portugal, Sweden and Switzerland only have the contractual form. Singapore and New Zealand only have the trust form. Some other jurisdictions (United Kingdom, Ireland, Canada and Hong Kong, China) that traditionally had the trust form, have now authorised corporate CIS. Japan and Korea previously only had contractual CIS, but have recently introduced corporate CIS.

D. A Functional Approach to the Categorisation of CIS

Thus far it has been seen that there is general agreement on standards and on the role of the internal compliance functions, but that legal structures for CIS diverge. As will be seen in the next section, the legal structures of the CIS, while one factor in the governance regime, only give a preliminary idea of the range of how OECD governance systems operate in practice. CIS having the same legal form operate differently in different countries while some of those having different legal forms operate in a similar way. Other factors, especially industry standards of best practice and market competition do also have a large role in determining the contours of the governance system.

V. Survey of Systems in Member Countries

This section provides an overview of the provisions for internal review of the activities of the CIS operator in OECD countries. Rather than following a strict categorisation by legal structure, systems are grouped by the way in which governance systems operate in practice. Systems of governance are divided into the following groups: a) the United States mutual fund system; b) continental European systems, especially those covered by the UCITS Directive; c) unit trust systems; d) Japan and Korea; and, e) other systems.

A. Mutual Fund Structure: United States

Although many countries have corporate CIS, the "mutual fund" as found in the United States is unique. The basic legislation for the collective investment sector is the Investment Company Act of 1940, which requires that all collective investment business be conducted through an investment company. Thus, each "mutual fund" is constituted as a separate corporation in which the investors are shareholders.

Most investment companies are closely linked to other financial service companies and usually have no employees of their own and no assets, other than the assets held in the investment portfolio of the fund. The services that the investment company requires, including investment management, shareholder administration, and custody and underwriting of fund shares, typically are provided by other entities under contracts with the investment company. Like other companies, the investment company will have a board of directors with both independent directors and interested directors (*i.e.* those who are also employees of the affiliated companies). Normally, both categories of director will be on the boards of more than one investment company sponsored by affiliated companies.

The decision to establish a fund is typically initiated by the investment management company. Once the fund is in operation, the board of directors of the fund monitors the service providers, including the

investment adviser, with respect to observing accepted standards and avoiding instances of conflicts of interest. The board reviews the fund's contract with investment advisers annually. The 1940 Act defines the investment adviser as an affiliate of the investment company. The directors of the investment company must determine that the contract with the adviser is consistent with the interests of investors. The board is generally responsible for monitoring the compliance programme of the fund, including compliance with rules concerning pricing, valuation, portfolio diversification and liquidity as well as limits on activities such as investments in illiquid securities or derivatives and the use of credit. The board must verify that investment policies have been in keeping with policies as specified in the prospectus. The board also selects the auditor and custodian and monitors transactions with affiliates. Committees on audit, pricing, legal compliance and nominations are often organised to give detailed attention to these topics.

The directors' principal duties include monitoring portfolio performance in the light of the fund's objectives. Some deviations from the management style described in the prospectus may be easier to identify than others. For example, the prospectus may fix limits on the shares of the portfolio that must be held in investment grade securities or companies with a given market capitalisation. It may be more difficult to determine whether a fund manager has actually pursued a value or growth strategy. If the portfolio manager of a given fund were to underperform his/her peer group and/or the benchmark index consistently, the board could highlight this fact to the management of the investment management company. In fact decisions to change portfolio managers are likely to be taken at the level of the investment management company but as a last resort the directors of the fund could replace the investment adviser. Fund directors are also expected to review fees and expenses in order to determine that fees are reasonable in relation to the services provided.

Major decisions concerning the investment company such as decisions to close funds to new investments, to change the investment strategy, to modify restrictions on investments, to merge or to terminate funds must be submitted to the board and some of these must be submitted to shareholders. Shareholders can exercise full voting rights to change the goals and policies of the companies as in other corporations.

The directors of investment companies owe a fiduciary obligation to shareholders under state and federal law as do directors of other companies. The most important federal statute for investment companies and their directors is the Investment Company Act of 1940, which sets forth their specific obligations. Directors also must comply with rules adopted by the SEC. Directors face potential legal liability for the performance of their duty. The directors of investment companies can be sued by shareholders for failure to exercise their oversight responsibilities properly. In recognition of this liability, most investment companies purchase Directors and Officers Insurance coverage for their directors.

In the view of the mutual fund industry and of the SEC, the independent director plays a pivotal role in the American system of fund governance. Many of the key decisions affecting the fund's operation must be taken by independent directors alone. The focus of recent efforts to strengthen the governance system for the mutual fund industry has involved the role of the directors of investment companies, particularly the independent directors, who are expected to assure that the investment company acts in the interest of the shareholders rather than of affiliated companies. Existing laws require that 40 per cent of directors be independent, though, as a practical matter the percentage of independent directors on most boards exceeds 50%. The industry and its regulators have given considerable attention to the role of independent directors and their role in protecting the interests of investors. Thus, the Investment Company Institute, the industry association for the United States mutual fund industry, formed a special advisory group that released a set of recommendations in June 1999 concerning duties of independent directors and the definition of best practices to strengthen a "culture of independence". The report recommended that 2/3 of directors should be independent. The means of selecting, evaluating and compensating directors were discussed and the duties of independent directors were specified. In October 1999, the SEC released for public comment proposed changes in regulations that would strengthen the legal accountability of independent directors and

further specify the duties of such directors. An increase in the required number of independent directors is also being considered for funds seeking to rely on certain exemptive rules.

The industry, with the support of the SEC, sponsors educational programmes to assist current and prospective independent directors to understand their role and to enable independent directors to take a more proactive role in fund governance. Directors of investment companies frequently use codes of conduct to guide their activities. Two commonly used sources of information regarding the role and responsibilities of directors are those of the Investment Company Institute and the American Bar Association.

B. Continental European Systems

There is great similarity, as well as some differences, among European CIS regimes. To a certain degree, this similarity is a consequence of the large volume of cross-border business that is taking place, partly as a result of the UCITS Directive. The laws of all EU countries as well as EEA countries and Switzerland have been adapted to incorporate the requirements of the UCITS Directive. Funds meeting the specifications of the UCITS Directive are eligible for authorisation in the CIS home state and can thereafter be marketed throughout the EC.

The distinction between domestic and international business is not very sharp. In several countries, funds domiciled in another centre, especially Luxembourg, are frequently marketed, alongside domestically domiciled instruments. This is fairly common in France and Germany for example. In some countries very few "domestic" CIS are found and domestic institutions mainly form UCITS outside their borders. For example, there are very few domestic CIS in Belgium and, until very recently, the Netherlands. Instead most CIS distributed in these countries were legal entities formed under Luxembourg law and marketed in the other jurisdiction. Even today, most CIS sold in Switzerland are formed by Swiss institutions in Luxembourg and marketed back into Switzerland. Many of these CIS are purchased by non-residents.

In some senses, the contractual model is the conceptual basis for CIS in continental Europe. Contractual funds are undivided collections of transferable securities managed on behalf of joint owners, whose rights are represented by units. The investors engage in a contract under which the investment management company agrees to execute a particular investment strategy as spelled out in the prospectus and other offering documents. Contractual funds, while not free-standing corporations, are legally distinct from the investment management company. The investors (or unit holders) may either hold joint ownership interests in the assets of the fund or in some cases the assets are held in trust. The directors of the investment management company are seen as ultimately responsible for assuring that policies are formulated and communicated on all relevant points and that adequate monitoring mechanisms are in place and all standards are observed. The directors of the investment management company are usually required to be independent of the management of the fund management company, but often are linked to the parent company.

The investor has no particular rights in selecting the management of the company or in changing the investment policy of the CIS. The main recourse of investors who are displeased with the actions of the investment manager is to liquidate the investment.

Several European countries have the corporate CIS form, usually along with a trust or contractual form. However, the corporate form in Europe differs significantly from the open-ended investment company structure of the United States. In particular, the American-style control mechanisms, which depend heavily on independent directors, are largely absent. The supervisory authorities and the investing public place

responsibility for execution of the investment strategy as well as surveillance of fund activities on the level of the investment management company, rather than on the level of the corporate CIS.

European CIS have also different internal control mechanisms than the American-style mutual fund. Responsibility for checking that all applicable laws and regulations are applied is lodged in a system of up to four levels of control. Depending upon the particular case, oversight responsibility will be divided among: a) the directors of the investment management company; b) depository; c) the independent auditors; and d) the supervisory authorities.

A key role is assigned to the independent depository, which is appointed by the investment manager. Beyond simply acting as simply custodian of assets, effecting payments and performing operations (back office) work, the depository fulfils a wide role in overseeing compliance with regulations. Oversight functions include verifying portfolio holdings and determining that investments and liquidations are effected at appropriate prices. The depository is also charged with assuring that NAV is calculated according to fund rules and that each transaction is consistent with laws, regulations and fund policies. Examples of the latter are the selection of securities for the investment portfolio and observance of investment limits or prohibitions. In certain cases, the depository is charged with asserting the claims of investors against the investment manager where the duty of the investment manager to investors may have been breached. The depository is required to be a separate company from the parent company, but ownership linkages between the depository and the parent company are often allowed.

The depository has the additional role of ensuring that obvious potential conflicts of interest, particularly in dealing with intermediaries affiliated with the investment manager and arrangements for payments in "soft dollars", are known to the directors of the fund and determined to be in the interests of investors. The activities of the depository are subject to scrutiny by the auditor.

The depository does not, however, have the function of the directors of a mutual fund in evaluating performance of the manager or changes in investment objective and related policies. The board of directors of the investment management company makes these decisions.

The main responsibility of the investment management company is to observe the stipulated standards, to pursue the investment objective as effectively as possible and to disclose fully at least as much information as is required. In cases where breaches of laws of neglect of duty occur, there is some possibility to hold the directors of the investment management company legally responsible. On balance, however, the investor's main defence is to liquidate the investment.

1. France

The French collective investment industry is the second largest domestic market after the United States. Two different types of CIS are found: a corporate CIS (SICAV -- Société d'investissements à capital variable) and a contractual type (FCP -- Fonds commun de placement). FCPs are gaining market share and now represent over 50 per cent of the market. While it would be legally possible for a French SICAV to have independent directors and to assign oversight functions to independent directors as in US style mutual funds, this is not common practice as it is not considered necessary. Instead, other rules and oversight procedures applying to both SICAV and FCP are seen as guaranteeing investor protection. In particular, the asset management company must be separated from its affiliated institutions.

The CIS assets must be held by an independent depository, selected from a list of institutions approved by the Ministry of Finance, who has responsibility for assuring that the CIS actions comply with applicable laws and regulations. All compliance procedures must be included in a written plan that is available for

review by the COB (the securities regulator). Each designated depository assigns an individual who is responsible for executing all compliance functions. The COB has set out the obligations of the depository. The depository must verify that the CIS complies with investment rules specified in the prospectus, the calculation of NAV and the rules used in valuing portfolio assets. The depository must examine the portfolio holdings at specified intervals. The depository makes sure that the holdings of the portfolio are compatible with the fund's stated objective.

In cases where rules are not observed, the depository must follow prescribed procedures and bring the infractions to the attention of a) the portfolio manager or the CIS operator, b) the auditor of the CIS and c) the COB or the judicial authorities. The depository participates in all basic points in the life cycle of the fund, including creation, change of investment manager, mergers and acquisitions or liquidation. The means whereby the depository carries out its functions are stipulated in a written agreement between the CIS and the depository, which must be available for inspection by the COB. The auditors of the CIS hold annual reviews with the depository to review compliance. The COB monitors all of these procedures.

The industry association (AFG-ASFFI) takes an active role in promoting codes of conduct and in reviewing promotional material. Codes of conduct stress that the manager of the CIS must act exclusively in the interests of the investors. Codes also cover issues such as best execution, soft commissions and responsibilities for accuracy in marketing. These codes, which have been approved by the COB and apply to the entire industry, are binding on both the investment management company and the individual portfolio manager.

Other items in the codes state that separate orders are required when a portfolio manager manages more than one portfolio. Portfolio managers must have at their disposal the means to carry out all necessary operations including the compliance function. A fund manager must not have other functions that would place him in a position of conflict of interest. A fund manager cannot manage the proprietary trading portfolio of the promoting group or depository. In order to avoid any risk of conflict of interest, a fund manager cannot buy, on behalf of the fund, unquoted shares issued by the management company subsidiaries or by the promoting group. A fund manager cannot be, personally or as a representative of a company, an administrator of a listed company in which the fund holds shares, nor can he participate in board meetings of such companies. AFG-ASFFI is currently drafting recommendations introducing the concept of independent administrator and audit committee.

The CIS industry has a disciplinary board composed of asset management professionals who investigate alleged violations of codes of conduct or other infractions of rules. Penalties can include warnings, fines or suspension.

The self-regulatory system is supported by official regulation. All CIS must be approved by the COB before public offerings. In deciding upon applications, the COB scrutinises the adequacy of resources of the investment manager, professional capabilities and the adequacy of supporting information. A consultative committee including only professionals and chaired by a member of the COB considers authorisation applications. In addition, the COB conducts on-site visits, reviews portfolio holdings and scrutinises marketing materials and prospectuses.

2. Germany

The Law on Capital Management Companies (KAGG) governs the organisation and supervision of CIS. German banking law furthermore defines investment fund management as a specialised form of banking and thus institutions engaging in CIS business (investment management companies –or KAG -- Kapitalanlagegesellschaften) are subject to bank supervision. The principal regulatory body charged with

the application and implementation of the investment fund law is the German Federal Banking Commission.

CIS in Germany have to be constituted according to contract law -- in other words, as a contractual fund managed by a management company. The investor acquiring a CIS unit enters into a contract with a manager whereby he acquires a share of a certain asset pool. The fund management company is the entity that issues units in the asset pool, and the investor is entitled to require the repurchase of those units by the manager.

Each KAG has a two-tier board structure similar to the governance structure for all German joint stock corporations. The management board consists of at least two members who are responsible for the daily investment decisions of the KAG and the funds under its management. The managers may take account of recommendations of the investment committee (see below). There is limited scope for delegation of core aspects of the fund management process with respect to investment management, fund accounting and fund controlling. In any case the responsibility cannot be delegated. The second tier of the two-board structure is the supervisory board, which has oversight responsibility over the management board. The supervisory board must have at least three members. The law requires that no member of the supervisory board may be a member of the management board, although a member of the supervisory board may be an employee of an affiliated company. The supervisory board is selected by the shareholders of the KAG. The supervisory board, which does not interfere in ongoing management of the company, is charged with safeguarding the interests of the unitholders of the funds. It meets regularly and receives information from the management board.

The supervisory authority has set norms concerning the number of meetings that must be held by the supervisory board of a KAG. The authorisation by the supervisory board is required for actions such as the establishment, transfer and termination of funds, changes in the rules of funds and selection of the depository. Usually, an investment committee is formed which is responsible for representing the interests of investors and makes non-binding recommendations concerning investment policies to the investment managers. The supervisory board appoints the members of the investment committee. They may be employees of affiliates of the management company and representatives of the institutional investor.

The KAG conducts transactions in its own name but for the CIS's account. The money contributed by the unit holder and the investments bought therewith do not form part of the KAG's own assets but are treated as separate funds bought by the KAG -- usually in the form of fractional co-ownership (securities funds) for the unit holder. The management company must keep the CIS's assets separate from its own assets and those of other CIS it controls. Such a pool or collection of segregated assets (Sondervermoegen) is a separate entity with no legal personality or existence. It is an unincorporated collection of assets. It has no employees, cannot transact business, and can neither sue nor be sued.

The assets have to be kept with, and must be supervised by, a custodian bank -- called Depotbank -- which must be a German banking institution subject to the supervision of the Banking Commission. All money invested becomes part of the Sondervermoegen, which is safeguarded by the Depotbank. The investor does not become a shareholder of the KAG but has merely a joint interest in the Sondervermoegen, represented by a certificate. The custodian bank is responsible for the safekeeping of the fund's assets. In addition, it sells and redeems certificates representing an interest in the Sondervermoegen. It verifies that purchases and sales of assets take place at appropriate market prices. The custodian bank acts solely in the interest of investors, but is subject to instructions by the manager unless these instructions are in violation of applicable law or the conditions of the contract with the investors. The appointment of such a bank requires approval by the Banking Commission.

These two devices--the creation of a Sondervermoegen and the appointment of a Depotbank--are the primary legal safeguards for investors in a German fund. German law provides significant safeguards for investors. It imposes a primary, fiduciary duty on the management company to act solely in the interest of CIS unitholders, and it provides for independent review of management by the fund's custodian bank, the independent auditors, and by the Banking Commission. Both Banking Commission and Depotbank may sue the fund management company for management's failure to act in accordance with the law. The Banking Commission may also fine or dismiss a manager who is unfit professionally or who violates laws or regulations. Furthermore, the independent auditors of the fund are not only charged with auditing the accounts of the CIS but must also certify that the fund has been managed in accordance with all applicable laws and regulations.

The Banking Commission's principal duties are the supervision of fund management companies, including the determination of the necessary qualifications of the two required managing directors of such companies. It also closely supervises the activities of these companies and the establishment and operation of the individual CIS they establish.

German laws concerning the kinds of fund that could be offered and other funds rules were relatively restrictive in comparison to those of some European countries until the late 1990s. Partly as a result, a large number of funds sold in Germany originated offshore, especially in Luxembourg. In 1990, 1994, and 1998, the law was revised allowing a broader variety of funds and management techniques to be offered. As a result, foreign funds have lost market share in the past few years.

3. Italy

Most CIS are UCITS of the contractual type. There are also some corporate type funds (SICAVs), but these are not in conformity with the UCITS Directive. The distributors organise asset management companies that usually manage several funds. These funds are mostly distributed through bank branch networks. The responsibility for acting in the interest of the investors lies with the directors of the asset management company, who are expected to have some independence from the distributor. The investor signs an investment management contract with the company and becomes a proportional owner of shares in the fund. All shares have the same value and rights. Shares are represented by registered or bearer certificates, at the choice of the investor. Each fund constitutes an independent pool of assets, separate from the assets of the asset management company and from those of each unit-holder, as well as from any other assets managed by the same company.

Asset management companies and SICAVs adopt and comply with a self-regulatory code of conduct that establishes the rules of conduct for the members of the administrative and control bodies, employees, salesmen and others in responsible position. The rules of conduct cover the obligation of data protection, limits on personal transactions involving financial instruments and a prohibition of receiving benefits from third parties that could lead to conduct contrary to the interests of investors.

In order to minimise the risk of conflicts between the pools of assets under management, asset management companies must implement internal procedures aimed at ensuring that exchanges of information do not occur between parts of the asset management company and with other group companies. Asset management companies also must identify cases in which the contractual conditions agreed with the persons who supply services to such companies might conflict with the interests of the investors and ensure that the CIS is not burdened with unnecessary costs or excluded from any legitimate benefits. In addition, asset management companies must establish an internal control function. The responsibility for such a function must be assigned to a person not having hierarchical position with the persons responsible for the sectors of activity subject to control. This function must be performed in an autonomous and independent

way. Custody of the financial instruments and cash of funds must be entrusted to a depository bank, which also carry out oversight functions. The depository bank is liable to the asset management company and unit-holders for any loss suffered by them as a result of its failure to perform its obligations. In performing their respective functions, the promoter, the manager and the depository bank must act independently and in the interests of the unit-holders.

Regulatory responsibility is divided between the Bank of Italy and the Consob (securities supervisory authority). The Bank of Italy, after consulting Consob, authorises asset management companies to engage in the provision of collective portfolio management services and the establishment of SICAVs. The rules of the fund must be made explicit and approved by the Bank of Italy in consultation with the Consob. The Bank of Italy makes sure that the fund follows agreed investment policies and is complying with rules about portfolio diversification and conflict of interest. The Consob is concerned with prospectuses, reporting, marketing practices and trading.

4. Luxembourg

As noted previously, Luxembourg is the pre-eminent international centre for CIS domiciliation in Europe. The assets of CIS domiciled in Luxembourg in mid 2000 were estimated to be the highest in Europe and second only to that of the United States in the world. Most of these funds are formed by promoters based in other countries. The laws of Luxembourg have been framed with the objective of incorporating all features of the UCITS Directive.

Luxembourg law permits the formation of CIS organised either under the law of contract, as funds managed by an investment management company (FCP) or under a special statute, as open-ended investment companies (SICAVs). An FCP has no legal personality and relies solely on its management company to transact its affairs. The management company of an FCP, whose activities are limited to the management of collective investment funds, is subject to authorisation by the regulator, the Institut Monétaire Luxembourgeois (IML), as is the fund itself. The fund is constituted by rules adopted by the management company, which are binding on all unitholders. The rules of management are subject to the provisions of the law of March 30, 1988 relating to undertakings for collective investment, which implements the UCITS Directive in Luxembourg. The investors (unitholders) are co-owners of the assets of the fund and parties to the contract.

The SICAV is a special purpose company whose exclusive object is to invest its funds in transferable securities in order to spread investment risks and to ensure for its shareholders the benefit of the management of their assets. The SICAV is constituted by means of articles of incorporation, the terms of which are approved by the IML. The directors, who are not expected to be independent of the management company, have a duty to act in the interests of the company but not shareholders individually. It is customary to appoint a separate administrator, based in Luxembourg, and a separate investment advisor, usually based outside Luxembourg. By separate contract, the management company appoints a depository.

In both kinds of funds, the management company has the exclusive right to manage the scheme in accordance with the provisions of the rules of management and the law. Investors generally have little direct influence over significant changes to both types of funds, but have the right to take action individually if the management company or depository breach their respective duties.

In the case of an FCP, there is usually no provision for unitholder meetings. Changes to investment policy or other matters relating to the fund are solely the responsibility of the management company, although it may not exercise its right to amend the rules of management unless to do so would be in the interests of

unitholders. Management fees are fixed initially in the terms of the rules of management. Other fees and expenses may be assigned as long as the nature of those payments is disclosed in the prospectus. There is no independent monitoring as to the reasonableness of fees. The management company is solely responsible for the selection of the depository and, while they may not have common directors, the two entities may be in the same group.

With regard to SICAVs, although shareholders have voting rights, they do not have powers as shareholders to approve significant changes to the fund. Unlike the FCP structure, shareholders do have the right to remove the board by shareholder resolution and thereby alter the management arrangements. The determination of investment policy is solely at the discretion of the directors and the directors have responsibility for settling the terms of investment management and other service provider agreements, including settling remuneration and fees and expenses. In practice however, boards of directors are associated with the investment manager promoting the fund and independent scrutiny of these matters does not occur. Similarly, the depository is under no duty to exercise monitoring functions in this respect.

Change of control in the management company of an FCP or an investment advisor is not subject to shareholder or unitholder approval in either type of fund, but IML approval would be required. In general, the IML will approve changes if sufficient advance notice is given by the investment company or management company to shareholders to allow them time to dispose of their units or shares if they do not agree with the changes proposed.

In both types of CIS, the depository must hold the assets of the scheme and exercise certain supervisory functions over the management company as required by Luxembourg law, which are similar to those of depositories in other continental European countries. The depository must ensure that the sale and redemption of fund units, settlement of fund securities transactions, and proper treatment of fund income are carried out in accordance with the law and the rules of management or articles of incorporation. Moreover, the depository of an FCP is charged with responsibility for ensuring that the value of the fund's units is calculated in accordance with the law and the fund's management regulations and carrying out the instructions of the management company unless they conflict with the law or the fund's rules of management. The law provides specifically that in the context of their respective roles, the management company and the depository must act independently and solely in the interests of unitholders. Luxembourg law imposes liability on the depository of either an FCP or SICAV to investors (and to the management company in the case of an FCP) for any loss suffered by them as a result of failure to perform its obligations or for improper performance. If the management company should fail to take action within a prescribed period, a unitholder may directly take action against the depository.

In an FCP, the management company has a contractual duty to unitholders to comply with the terms of the management regulations. In an investment company, the directors owe duties to manage the company in accordance with the law and the articles of incorporation and are liable to the company (but not directly to investors) for their failure to do so. The investment adviser of an investment company owes contractual duties to the investment company, but not directly to investors, to perform the terms of the agreement.

Luxembourg law contains nothing specific on conflicts of interest. However, since the investment management of Luxembourg funds usually takes place outside Luxembourg, the investment adviser or manager of a Luxembourg fund may be subject to conflicts of interest regulations in the adviser's or manager's home jurisdiction.

5. Belgium

Before 1990, nearly all CIS offered to domestic residents were incorporated in neighbouring Luxembourg. In 1990, a major overhaul of the law was introduced to enable domestically organised CIS to compete with offshore products. Rules concerning the delegation of activities were clarified. In keeping with practice in most other countries, outsourcing was authorised subject to requirements for more transparency concerning fees paid for all services. Additionally, it was forbidden to charge fees for the portion of CIS assets that are invested in funds sponsored by the same group.

A CIS can be constituted as SICAV (corporate form) or as an FCP (contractual form) managed by a management company. Most CIS are offered by investment management subsidiaries of Belgian banks. In order to be licensed by the Banking and Finance Commission (BFC), the investment management company must demonstrate that it has adequate capability from the accounting, administrative financial and technical viewpoints to carry out its tasks and to guarantee autonomy of management. In the past few years, the authorities have taken several measures to ensure the independence of fund governance, to require more transparency concerning fees and to broaden the scope for competition.

In contrast to the ordinary corporate law in Belgium under which directors must take into account the interests of several groups of stakeholders, directors of investment management companies must only take account of the interests of the investors. This mandate to act exclusively in the interest of investors has been reinforced by subsequent laws and decrees.

Belgium has some of the strongest provisions in Europe concerning the independence of decision-making in the investment management company. The law requires that the board of directors of a fund in corporate form or of an investment management company should have a diversified and well-balanced composition. The majority of directors should have some independence of the promoter of the CIS. The supervisory authority further recommends that at least two directors be fully independent. The Belgian law does not require that the depository be fully independent of the promoter. The depository may be represented on the board of the investment management company. However, if the depository is not independent of the promoter, this person cannot be a member of the board of directors.

As in other European countries, the depository is also entrusted with significant oversight responsibility. The depository has to ensure, for example, that NAV is calculated and the issue and redemption of the units takes place in accordance with the applicable laws and regulations, with the fund's rules or the articles of incorporation of the CIS.

6. Netherlands

Two types of CIS are found in the Netherlands:

- The corporate form investment companies (Nammloze vennootschap), where units of the CIS are shares in the company. Management of corporate CIS can be undertaken by natural persons or investment management companies. Open-ended corporate CIS are typically "investment companies with fluctuating share capital". Classification as such allows the company to issue and redeem shares on an ongoing basis. Such a company must be listed on the stock exchange.

- The contractual form (Fond voor gemene rekering) which are unincorporated entities that are constituted by assets that are administered and held by third parties (the custodian) for the benefit of the unit holders. CIS in this form must be managed by an investment management company.

Sponsors of CIS fall into four groups: banks, insurance companies, property managers and other asset managers. The main distribution channels for funds are via banks and direct selling. It is estimated that 30 per cent of all mutual fund sales are made via direct marketing, 10 per cent by IFAs (although their market share is declining) and 60 per cent through bank branch networks.

The Act on the Supervision of Investment Institutions (ASII) of 1990 forms the basis for the supervision of CIS. Those funds quoted on the stock exchange (*i.e.* those in corporate form) are regulated by the exchange itself. For CIS not listed on the stock exchange, the supervising authority investment is the central bank. The central bank's regulation of the collective investment industry is driven by two specific mandates: 1) to facilitate the proper functioning of the financial markets and to enhance the transparency of the financial sector; and 2) to protect "public" investors. Supervision by the central bank focuses on the investment institution's legal and organisational structure and the supply of information to the public. The laws recognise special investment partnerships and collective investments offered only to institutional investors. These instruments are exempt from regulation.

The ASII requires investment institutions to disclose certain information to the public. For example, a prospectus must be made available to all potential investors. Every investment institution must provide a monthly overview containing information such as the total value of investments and the number of units outstanding. Investment institutions must provide quarterly figures to the central bank, as well as publish and submit half-yearly statements. Also, annual accounts and the annual report must be submitted within four months of the end of the financial year.

A Dutch institution wishing to obtain a licence to market a CIS must apply to the central bank for authorisation. In order to receive authorisation, the institution must show that:

- The head office of the investment company or of the investment management company of the contractual CIS trust is established in the Netherlands.

- The activities of the management company of the contractual CIS are restricted to managing investment institutions.

- The investments of the institution are deposited for safekeeping with a custodian which is independent from the investment institution.

- The custodian is established in a member state of the European Union and has an establishment in the Netherlands.

The ASII also prescribes that the investment institution must have a "well-functioning administrative organisation," enabling a correct and complete overview of the size and composition of its financial position. The central bank assesses the set-up of these administrative organisations and conducts examinations, evaluations and discussions with both management and the institution's external auditor.

7. Denmark

Only the contractual type of investment funds is present. The legal organisation of a Danish investment funds is an "association", in which all investors are members and where the membership entails right to vote at the general assembly, which is the highest authority. The general assembly chooses the board of directors, appoints a manager and the depository. The manager is usually a limited company, fully owned by the association, which must only service investment funds. This limitation, which is based on the UCITS-directive, has been introduced to ensure that the professional fund managers use their best effort to

the benefit of the fund and thus avoids conflict of interest. The custodian must be a Danish bank, and it is often the promoter of the investment fund.

An important feature of the system is the independence of the investment fund and management company of the promoting bank. Operations must be conducted at arms' length. The majority of board members must be independent of the depository company. The promoter-banks usually also sell other funds in addition to their proprietary funds. The investment funds and their management companies are under continuous surveillance by the State Financial Supervisory Authority.

8. Spain

Two types of CIS are found in Spain. One is the Investment Fund (IF) -- a contractual CIS in which net assets are divided into units which are, at the request of the holders, issued and redeemed daily at NAV. An IF is managed by a management company. The other form of CIS is Open-ended Investment Companies (OEIC) which must also issue or redeem shares at NA on a daily basis.

In both cases, the CIS's assets must be entrusted to a depository for safekeeping. Both management company and depository must be entities duly licensed in Spain to carry out such activities and no single company can act as both management company and depository. No institution may be depository of a CIS managed by a company belonging to the same group, except when certain norms of separation between both to guarantee their independence. In the context of their respective roles, the management company and the depository must act solely in the interest of the investors. Transactions aimed at furthering the interests of group or related companies of the management company and the depository, or the interest of their managers or directors, are unlawful.

Investment decisions are taken at the CIS operator level and must be made exclusively in the interest of CIS investors. CIS operators are subject to rules of conduct which are codified in the law or internal codes. They must defend clients' interest, avoid conflicts of interest, have a proper organisation, erect effective institutional separation to implement risk control systems, abstain from insider dealing and other conduct. CIS operators must impose institutional separation of functions, *i.e.*" Chinese walls", in order to minimise exposure to conflicts of interest. A compliance officer monitors adherence to standards.

9. Portugal

In Portugal only the contractual type CIS is recognised. A CIS is managed by a management company, which must be a credit institution established in Portugal with activities restricted to CIS' management. The CIS assets must be entrusted to a depository for safekeeping. Both management companies and depositories perform their functions independently and solely in the unit-holders' interest.

The investment decisions must be entrusted to persons that perform these functions only within the management company. "Chinese walls" and other internal control measures must be implemented at a group level in order to ensure proper separation between particular sensitive areas. CIS operators are subject to rules of conduct. These rules require that they act with competence and due diligence, defend clients' interests and avoid conflicts of interest in CIS they manage, implement risk control systems, abstain from insider dealing and improper conduct in the market and disclose required information to investors.

10. Switzerland

Only the contractual form of CIS is recognised under domestic law. Under the Investment Funds Act (IFA), the assets must be managed by a fund management company and kept in safe custody by the custodian bank, which also has supervisory tasks with respect to the compliance of the management company with the prospectus and the applicable statutory and regulatory rules. To minimise conflicts of interest, the IFA requires a separation of staff and infrastructure between management company and custodian bank. Moreover, the IFA imposes a strict fiduciary duty on both CIS operator and custodian bank to act in the sole interest of the investors. Therefore, no business transactions of any kind between management company and custodian bank are allowed, except buying and selling listed securities. The Swiss Funds Association (SFA) has recently adopted a thorough Code of Conduct that is scheduled to be approved by the Federal Banking Commission (FBC). The FBC will enforce compliance with this Code of Conduct by all management companies.

While the contractual form is the only product authorised domestically, about 80 per cent of funds marketed to Swiss investors are domiciled offshore, especially in Luxembourg. This partly reflects the legal regime. Thus, Swiss law did not until recently recognise money market funds and thus all money market funds were foreign-domiciled. On the other hand, the UCITS Directive does not recognise real estate funds, a popular investment instrument, and hence all such funds are domestic. Offshore funds are mostly SICAV-style corporate funds, which are in conformity with UCITS specifications. Although Switzerland is not an EU member, practices are closely aligned with those of the EU.

Swiss banks are major players in the European asset market and funds managed by Swiss banks are marketed internationally. Until recently, the market was dominated by Swiss banks who held more than 90 per cent of the market, with the big three Swiss banks in turn controlling nearly three fourths. Recently, however, distribution sources have become more varied.

11. Sweden

CIS are constituted as contractual-type funds managed by a management company. All funds are required to have a depository, which is a bank or other credit institution that acts as custodian of the assets of the fund and processes incoming and outgoing payments of the fund. The management company and depository must act independently of each other and exclusively in the interest of the unit-holders. The CIS operator must have systems of internal controls and internal audit, risk measurement and valuation. The Mutual Funds Association has developed on its own initiative "Ethical Guidelines for Management Companies" binding on its members but these rules have no legal effect.

12. Greece

In Greece, open-ended mutual funds are of a contractual type. Closed-ended type investment vehicles of a corporate type are also found. The fund is managed by a mutual fund management company (MFMC), regulated and controlled by the Capital Market Commission. The assets of a CIS must be deposited with depository which must be a credit institution established in Greece. The depository is liable to the MFMC and the unit holders for negligence in fulfilment of its obligations. The MFMC and the depository, in the exercise of their duties, are obliged to act in a way independent of each other and exclusively in the interest of the unit holders.

It is the responsibility of the MFMC to enforce the autonomy and independence of all investment management decisions and investor protection measures. The MFMC is also responsible for its

organisation and the effectiveness of the internal control procedures. Internal controls are strictly regulated and regularly supervised by the regulators. There is an enforceable code of conduct for all CIS. It provides for the autonomy of the management, the confidential nature of investment decisions especially within the group companies and the CIS responsibility to implement internal controls effectively.

C. Trust structures

One of the major legal forms of organisation for CIS is the trust form, which is usually called a "unit trust". The trust is a special form found in Anglo-Saxon law under which assets are owned by the trust and invested on behalf of the beneficiary. A unit trust scheme is formed on the basis of a legal trust with both a trustee and a fund manager responsible for its operation. In this scheme the investment manager is generally given the responsibility of managing the CIS and deploying its assets while the trustee exercises surveillance to assure that all regulations are observed and that the investment manager acts in the interests of the investors. This form of CIS is found in jurisdictions where the English common law system prevails (other than the United States).

The investment manager and trustee jointly sign the "trust deed", which determines how the trust is to be established. The trustee must be approved and registered as a trust company by the competent authorities, which must certify that they have required expertise and are financially sound. The trustee must usually be entirely independent of the investment manager. Trustees must not, for example, be related through a common shareholding structure to the fund manager. Most trustees are themselves banks or wholly owned subsidiaries of banks, but the same bank cannot have subsidiaries that act as trustee and engage in asset management work for the same fund. The trustee verifies that borrowing limits are observed and that all funds that should be received by the fund are actually received. The trustee notes all breaches of compliance and requires corrective action. When such action is not taken, the trustee contacts the board of the investment manager and/or the regulatory authorities. While the manager will usually be the first port of call, disgruntled unitholders have recourse to both the trustees and the regulatory authority. In addition to their core surveillance work, some trustees do NAV calculation, maintain registers, and perform periodic tests of valuations if performed in-house. The trustee may also act as custodian.

The trustee owes a fiduciary duty to the unitholders and acts to safeguard their interests. Trustees have all the fiduciary obligations imposed by trust law as well as additional obligations under the relevant CIS regulations. This allows the manager to concentrate on investing and generally operating the unit trust, within the constraints imposed by both the regulations and the trust deed.

The trustee or the depository has responsibility for the safekeeping of client assets, (*i.e.* the underlying assets of the fund). These assets, which include income arising from the holding of property within the fund, are held in the name of the trustee or depository. All the income must be distributed or accumulated for the benefit of the unitholders or shareholders.

An investor in a unit trust scheme is issued units that represent a beneficial interest under the trust in assets of the investment fund in direct proportion to the number of units owned. The trust deed, the basic contract between the investor and the investment manager, specifies the terms of the contract, including the identities of the investment manager, the trustee and the depository. The trust deed also spells out the investment objective, as well as any limits on fund activity, such as concentration, use of credit short sales or derivatives.

Although the trust structure represents a time-tested means of organising CIS, it seems fair to say that the unit trust form is in a state of flux. In the United Kingdom and Ireland, participation in the European CIS market is encouraging a shift toward structures geared to that market. In Australia the recent overhaul of

the laws regarding investment management has altered the nature of unit trusts fundamentally. In Canada the system operates differently than in other countries using the trust system and many are calling for basic reforms.

1. United Kingdom

All investment firms in the United Kingdom are regulated, but CIS are the only financial products that are directly regulated. The regulations, which provide the bulk of the law relating to unit trust schemes, are the Financial Services (Regulated Schemes) Regulations -- partly made to conform to the 1985 UCITS Directive. Although most other EU members have different legal structures of CIS, the unit trust structure is compatible with the UCITS Directive.

A unitholder in a unit trust is free to redeem the investment at any time by sale of the units or shares back to the manager. The manager must make payment upon redemption within four business days of receiving renunciation of title from the investor. The units are issued at a price that is strictly regulated by The Financial Services (Regulated Schemes) Regulations of 1991. A manager must exercise due diligence in exercising the pricing function. Where an error in pricing occurs, the manager is obliged to compensate the investor or the trust unless the error involves very minimal loss. It is the trustee as part of his fiduciary duty towards the unitholder who must decide whether or not compensation should be awarded.[2]

While units trusts are the traditional CIS used in the United Kingdom, the laws have recently provided for the formation of corporate CIS known as Open-Ended Investment Companies (OEICs). OEICs effectively combine many of the features of a corporate fund and those of a trust based fund. A driving factor in the introduction of such vehicles was that they would be easier for international investors to understand than unit trusts. OEICs provide an equivalent level of investor protection as unit trusts and from the investor's point of view there is reportedly little difference between the two. Many existing unit trusts are being converted to OEICs that are being marketed both domestically and internationally.

Investors purchase shares in the OEIC. The two bodies responsible for the operation of an OEIC are the authorised corporate director (ACD) and the depository. Their roles and responsibilities are very similar to those of the manager and trustee of a unit trust. The ACD, which may be the sole director of the OEIC, has primary responsibility for managing and administering the OEIC. Both bodies are responsible for ensuring compliance with the regulations. However, like the trustee of a unit trust, the depository performs an independent function (on behalf of the investor), in overseeing the ACD's activities. Fundamentally, the same requirements are to be met in order to act as an ACD as those for the manager of a unit trust. The ACD must be a corporate body and must be specifically authorised to act as an ACD (currently through membership of the investment management self-regulatory organisation, IMRO). The same body may be both the ACD of an OEIC and the manager of a unit trust, provided it has first applied to IMRO for an extension of its permitted business. The depository must also be specifically authorised and must be independent of the ACD.

An OEIC must always have an authorised corporate director. There is no obligation to have any further directors, although there is no bar on there being further directors. No OEIC has apparently appointed more than one director, on the basis that it is unclear what their role would be and what they would add given the role of the depository.

---

53. Units may be single or dual-priced. The provisions within the regulations applicable to a unit trust incorporating dual pricing contain a prescribed formula for the pricing of units. Where the units in a trust are single-priced the regulations offer principles of pricing, while the trust deed must set out the detailed methodology.

2. Ireland

In Ireland two types of open ended UCITS funds are found: unit trusts and open-ended investment companies. An Irish unit trust is constituted in exactly the same way as its UK counterpart. A unit trust operates as an investment fund established under a trust deed made between the management company and the trustee.

Irish investment companies are registered under a series of Acts called the Companies Acts 1963 and 1999. The shareholders of the company enjoy limited liability. The investment company has a board of directors, who hold overall responsibility for the management of the investment company and compliance with the regulations. Irish companies must have a minimum of two Irish directors.

The board of an investment company is selected by the investment adviser or promoter. The directors need not be independent of the management company or investment adviser. The directors owe fiduciary duties to the company but not directly to investors, while a unit trust management company has a fiduciary duty to unit-holders. Individual investors therefore may find it easier to enforce remedies for wrongdoing in the case of a unit trust than an investment company.

While the trustee is an integral part of a unit trust structure, authorised investment companies are required to appoint a custodian. The duties of the custodian of an investment company and the trustee of a unit trust are equivalent. They are to hold the assets of the investment company and exercise certain oversight functions so as to monitor compliance by the investment company with the memorandum and articles of association and UCITS regulations. The trustee or custodian will be liable to the management company, investment company, or investors for any loss suffered by them as a result of any unjustifiable failure by it to perform its obligations as a trustee or custodian or for improper performance of those obligations. The trustee or custodian must not share common directors with the investment company or management company. A management company, investment company and custodian or trustee must act independently and solely in the interests of the unit-holders.

The rights of investors in respect of significant changes to the fund are equivalent in the case of both types of fund. Approval of investors by resolution (75% majority of those voting) is required for significant changes to investment policy or remuneration of service providers.

3. Australia

Major changes have occurred over the past decade. Traditionally, Australia had a unit trust system fairly close to that of the United Kingdom whereby unit trusts were regulated as “managed investment schemes” under the Australian Corporations Law. However, in the late 1980s, problems of large losses, illiquidity and inability of trustees to perform effective monitoring led to a prolonged reappraisal of existing structures. An extensive investigation into the collective investment sector was carried out between 1991 and 1997 by a joint commission of the Australian Law Commission and the Companies and Securities Advisory Committee. This review coincided with a general review of financial supervision that led to a realignment of responsibilities among various agencies. Significant changes in the legal regime for unit trusts were included in the Managed Investments Law of 1998.

The law covered all CIS that were to be offered to the general public (any plan with more than 20 members). The previous institutional system that included a management company and independent trustee was replaced with a single “*responsible entity*” (RE). The law imposes certain obligations on the RE concerning the duty to act in the interests of investors and to treat all categories of investors equally. Instead of the trust deed, the RE is required to have a *constitution*. The RE has responsibility for

management of the scheme as well as for enforcement of all investor protection norms as specified in the laws and regulations and by the internal rules of the CIS as outlined in the prospectus. The RE may delegate some functions but still retains responsibility. The law identifies a number of conflicts of interest and requires the RE to disclose and justify related party transactions.

All CIS must be approved by the Australian Securities and Investment Commission (ASIC). One requirement for approval is that the RE must have an approved compliance plan and demonstrate a capability to carry out investment management business as well as the compliance plan. Among the considerations used by the ASIC in deciding whether to grant authorisations are: a) the organisational structure of the CIS; b) the adequacy of its accounting, computer, compliance and operating systems; c) the education and experience of relevant officers of the applicant and, where key responsibilities of the operator have been delegated to an agent, of that agent; d) the "good fame and character" of those officers; e) the processes used by the operator for selecting, appointing and monitoring agents; and f) the compliance structures to be adopted for the scheme.

The law sets forth mandatory governance structures that include the following elements:

- The *compliance plan*, which must be lodged with ASIC, sets out adequate measures that the RE will apply in operating the scheme to ensure compliance with laws and the scheme's constitution. A compliance plan prepared in accordance with ASIC policy is generally a fairly detailed and lengthy document. The compliance plan may be amended by the RE, and must be amended at the direction of ASIC. Any breach of the compliance plan implies statutory sanctions and remedies.

- In cases where less than half of the directors of the RE are independent, a *compliance committee* must be established. The statutory functions of the committee are: a) to monitor compliance by the RE with the compliance plan and to report its findings to the RE; b) to report to the RE actual or suspected breaches of laws or the provisions of the scheme constitution; c) to report to ASIC when the RE does not take appropriate action to deal with such matters; and d) to assess at regular intervals the adequacy of the plan and make recommendations for improvements. The manner in which the committee performs these functions will be set out in the scheme's *compliance plan.*

- An annual compliance audit must be performed by an independent auditor and submitted to the RE and the AISC.

- An approved custody scheme must be developed, which usually requires an independent custodian.

- Rules governing annual and semi-annual reporting must be observed. All registered CIS are required to produce an annual audited financial report, including financial statements. The financial report must comply with the accounting standards and give a true and fair view of the financial position and performance of the scheme, and must be audited by a registered company auditor. The CIS must also produce a directors' report, setting out detailed information about the CIS (including the value of assets, the number of interests issued or redeemed during the period, and fees paid to the RE and its associates) prescribed by the statute. These reports must be lodged with ASIC and sent to the scheme members.

- Scheme members may vote on certain important issues. In each case the decision requires the approval of the required majority (but not all) members. The right to vote on other matters may be conferred by the constitution of the scheme. The approval of the required majority is

required for the appointment of a new RE or to amend the constitution sand for certain related party transactions. A members' resolution is one of the grounds on which the RE may be removed or the scheme may be wound up.

4. Canada

In Canada, the unit trust system has been used, but some CIS with corporate structures are present as well. Regulation of collective investment business takes place on the provincial level, although Ontario often tends to be a leading force in setting securities regulatory practice. For many years, Canada has viewed investments in CIS simply as arrangements to obtain portfolio management expertise, rather than as acquisition of shares in special investment vehicles. Relatively little attention was paid to potential problems of governance or to the design of robust systems to adjudicate conflicts of interest. Unlike other jurisdictions with the trust system, the trustee has not been required to be independent of the investment manager. At the same time, the authorities have imposed many restrictions on the operations of CIS that many in the industry believe have hampered the competitiveness of the industry. Instead of relying on the internal governance mechanisms of CIS to mitigate conflicts of interests, the approach has been to issue blanket prohibitions. For instance, it is forbidden for CIS to purchase primary market securities underwritten by affiliated financial institutions. Since there are a relatively small number of institutions active in the primary market, this is a very significant obstacle to CIS participation in primary offerings.

Over the past two decades, the Canadian governance system has been under extensive review by both official and industry groups. None of these reviews has been conducted in the context of any crisis, and the two most recent reports were commissioned due to the rapid increase in CIS assets. A 1995 report to the Ontario Securities Commission (the Stromberg Report) noted that there was no party in the Canadian structure for independent review of the fund operators or who is unequivocally mandated to act solely in the interests of investors. The Report recommended the legal requirement of an independent board or comparable body with oversight responsibilities. It also called for the establishment of independent audit committees with some defined responsibilities, for example in terms of the allocation of expenses to funds and the approval of annual financial statements. The Report also suggested a movement away from strict prohibitions to flexible governance arrangements and codes of best practices for fund managers and for investment funds. It also called for more comprehensible authorisation procedures on the part of regulators. A more recent report (the June 2000 Erlichman Report) repeated similar criticisms and mapped out possible ways in which a robust governance structure could be erected.

5. New Zealand

A trust system is used. The manager of the trust, who is responsible for day-to-day operations, must be independent of the trustee and post a bond with the government securing the discharge of its obligations under the Unit Trusts Act. There are about thirty fund managers who offer a multiplicity of unit trusts. Unit trusts must be approved and registered by the Ministry of Commerce before they can be promoted to the public.

As in other jurisdictions with the trust system, the unit trust is based on a trust deed between the trustee and the fund managers, which sets out the rules by which the trust must operate. The independent trustee is responsible for the safe custody of the trust's assets; ensuring that the trust is managed according to the rules set out in the trust deed; and ensuring that all assets are correctly registered in the name of the trustee or its nominee company. These responsibilities allow the trustee to oversee the trust's operations so that unit holders' interests are safeguarded. As a further safeguard, an independent auditor audits the trust's

accounts annually and a report is sent to all unit holders as well as being filed with the district Registrar of Companies.

Group Investment Funds (GIFs) in New Zealand are very similar to unit trusts. The significant difference is that the trustee and the manager are the one and the same. The trustee/manager must be one of a limited number of statutory trustee corporations established in New Zealand. The GIFs have traditionally been biased towards fixed interest securities and investments secured by mortgages, rather than equities or other investments which offer higher potential returns with a higher level of risk. However, GIFs are now offering an increasing range of asset classes. GIFs are formed under the provisions of the Trustee Companies Act 1967. Legislation requires the trustee/manager to invest with the care, diligence and skill that a prudent person would exercise in the management of the affairs of others.

6. Hong Kong, China

The most common types of CIS are open-ended corporate-type mutual funds and unit trusts. If the CIS operator is locally domiciled, it is required to obtain a licence from the Securities and Futures Commission (SFC). Foreign investment managers are required to appoint a Hong Kong Representative Company.

The trustee or custodian is responsible for monitoring the investment manager's conduct in relation to the CIS, holding control of all CIS assets and taking reasonable care to ensure that the CIS documents comply with the regulations. The trustee, custodian and the CIS operator must act independently and solely in the interest of the investors of the CIS. Any transactions between the CIS and the CIS operator or its connected persons may only be made with the prior consent of the trustee or custodian, carried out on arm's length terms and consistent with best execution standards, and may not in aggregate account for more than 50 per cent of the CIS's transactions in value in any one financial scheme year.

There are also rules applicable to the operation of "house accounts"(account owned by the CIS Operator or any of its connected persons over which it can exercise control and influence). Where a CIS operator is part of a group of companies that undertake other financial activities such as corporate finance, banking or broking, it should ensure there is an effective system of functional barriers in place to prevent the flow of confidential or price-sensitive information between the different areas of operation and written procedures to document the controls. There is also a requirement for segregation of duties: front office functions from back office functions; compliance from audit functions; the investment decision making process from the dealing process.

A "Fund Manager Code of Conduct" sets out the conduct requirements for persons whose business involves the management of collective investments. A product code for CIS called "Code on Unit Trusts and Mutual Funds" governs the authorisation requirements for CIS and on-going obligations of CIS Operators. The SFC also has a set of internal control guidelines called "Management, Supervision and Internal Control Guidelines for Persons Registered with or Licensed by the Securities and Futures Commission".

7. Singapore

The system is modelled on that of the United Kingdom, with the unit trust being the predominant form of CIS. Unit trusts are regulated by the Monetary Authority of Singapore (MAS) and are covered by the Companies Law as well as under the Securities Law. Investment Managers are licensed and regulated under the Securities Act. The Investment Manager has the obligation to act in the interest of the investor, and in accord with the fund mandate, and to obtain best execution for clients. The Investment Manager

may delegate responsibility to the trustee, but retains final liability. The distributor must have a dealer's license under the Securities Act. The main contract between the unit holder and the Investment Manager is the trust deed. The trust deed specifies how units are valued. Most are valued daily, but this is not required. The fund's objectives and risk profile are also specified.

Each investment management company has a compliance unit that assures that the managers are acting in accord with MAS regulations and the rules of the fund. The MAS spot-checks the performance of firms to be sure that the compliance department is performing its functions properly.

The Investment Manager appoints the trustee who must be approved as a trust company by the MAS, which certifies that they have required expertise and are financially sound. Trustees have all the fiduciary obligations imposed by trust law as well as additional obligations under the Securities Act. Most trustees are wholly-owned subsidiaries of banks, but the same bank cannot have subsidiaries that act as trustee and engage in asset management for the same fund.

The trustee checks for inappropriate securities, if the fund's rules have been violated, if borrowing limits are exceeded, or if a fund holds more than 10 per cent in the securities of a single company. In addition the trustee verifies that the prices at which transactions take place are reasonable. Also the trustees reviews fees and charges. If the Investment Manager has used some brokers excessively, they will be subjected to more intense scrutiny. In addition to their core surveillance work, some trustees do NAV calculation, maintain register, and perform periodic tests of valuations if performed in-house. The trustee may also act as custodian. It notes all breaches of compliance and will discuss breaches with the investment manager or the MAS as appropriate. The trustees hear complaints from shareholders who have recourse to both the trustees and the MAS.

The investment manager is obliged to maintain a register of unit holders, which must be available to trustees and auditors for inspection. The system relies heavily on reporting and disclosure. Each company has to appoint an external auditor. A semi-annual and an annual report are usually issued, but only the annual report is audited, by an external auditor. Unlike monitoring by the trustee, which takes place on a continuous basis, the funds books are audited every year.

Unit trusts can be used to invest savings held by the Central Provident Fund (CPF), the mandatory savings scheme that can be used for specified purposes such as housing, medical care and retirement. Those Investment Managers who wish to be included in the panel of managers offering products to CPF members have to be evaluated and approved by CPF. Moreover, CPF members may only use their CPF funds to purchase unit trusts, which are approved by CPF. The approval process entails evaluation of the suitability of the product for investment by CPF members.

The asset management industry has been growing rapidly in the past few years, with about $100 billion under management. At the same time, penetration is still low. CIS units account for only 3-5 per cent of financial assets, partly due to the overwhelming role of the CPF in savings.

D. Japan and Korea

In these two countries, unlike most other OECD Members, the CIS sector was not very dynamic during the 1990s. This is partly the result of weak performance of equity markets. While both countries have high savings rates, asset holdings tend to be concentrated in traditional instruments, such as bank deposits. In both cases, there are histories of heavy government involvement in financial intermediation, discouragement of financial innovation and use of financial institutions to support government industrial policy aims. However, in the past 2-3 years, basic changes in financial laws and policies have been introduced designed to place institutions and supervision on a more market-oriented basis. These reforms

have included changes in the legal structures of CIS and measures designed to reform governance in the CIS sector.

1. Japan

The traditional Japanese form of CIS is the Securities Investment Trust. However, the trust concept is not deeply rooted in the Japanese legal system, and this system has many attributes of a contractual system. The trust is established by an agreement between a management company and a trustee, who serves as custodian of the CIS assets. Each management company is subject to licensing and supervision by the Financial Supervisory Authority (FSA). The Investment Trusts Association (ITA), which operates as an officially licensed self-regulatory organisation, monitors compliance with its own Conduct of Business Rules, guidance and recommendations. Conduct of Business Rules covers matters such as self-dealing and conflicts of interest, pricing of units and marketing of units including rules regarding advertising. The ITA has a Fair Practice Commission, which determines disciplinary measures to be taken against member companies in case of violation of the rules.

Changes in legislation in December 1998 made it possible to establish corporate CIS in addition to investment trusts. Following initial reforms in the late 1990s, a further round of reform of CIS legal structures and governance revisions took place recently. In May 2000 the draft bill to revise the current investment trust law was enacted, expanding the scope of permitted investments, previously restricted to principally marketable securities to a much wider range of asset, such as real estate and commodities.

The new Investment Trust Law re-designates the existing Securities Investment Trusts (SIT) as Non-discretionary Investment Trusts (NIT). For an NIT, investment of the trust assets is the responsibility of an investment trust management company (ITMC). Administration and safekeeping of the trust properties are the responsibility of a trustee company or a bank with trust operation. The NIT will invest primarily in marketable securities.

A Discretionary Investment Trust (DIT) is an investment trust that pools funds from a number of investors based on a single trust contract, with the trustee company investing these funds predominantly in a pre-determined class of asset at its own discretion. A DIT does not have to operate through an ITMC. The DITs will invest in special asset classes, such as real estate, rather than marketable securities.

The corporate form of CIS (previously SICs) will be called Investment Corporations (IC), having the status of a juridical person established either for investing in negotiable securities or in other assets such as commodities and real estate. The IC will be distinct from the investment management company. ICs will entrust certain functions, such as asset management, custody of the fund assets, the general business administration and the subscription of investment units to outside companies (*e.g.* investment management companies, asset custody companies or general business administrators.) The investment management company will hire all employees. An IC must be registered with the FSA by filing the articles of incorporation and other documents stipulated by the Ministerial Ordinance in advance.

The board of directors of ICs consists of executive directors and supervisory directors who are appointed at the general meeting of investors. The executive directors, who are employed by the ITMC, represent the IC and must exercise their duties in good faith in the interest of investors of the IC. The supervisory, or non-executive, directors monitor executive directors. They must be independent. The promoter, the directors and employees of the promoter (if the promoter is a juridical person), and the directors and employees of the distributing company are not eligible to serve as supervisory directors. The supervisory directors may require at any time that executive directors, ITMCs, asset custody companies and general business administrators report the situation related to the business and the assets of the IC. The

supervisory directors may also conduct investigations. A supervisory director must also exercise good faith in the interest of investors of the IC. The number of supervisory directors must exceed the number of executive directors at least by one. When executive directors and supervisory directors damage the IC by illegal activities, they are liable for damages jointly or severally.

The ITMCs are required to exercise good faith in the interest of the beneficiaries when giving directions related to management of the trust property or managing ICs. The new legislation clarifies the duty to act as a right and proper asset manager with the care and diligence of a prudent person. Certain trades that involve conflicts of interest are prohibited. For example, the law prevents persons or companies that have influence over the action of the ITMC from giving instructions to the ITMC to carry out trades for the benefit of themselves or their clients. The FSA undertakes monitoring of management company's compliance with the terms of the rules and its fiduciary duties. In addition, the FSA can revoke authorisation in the case of serious breaches of the rules.

It would appear that the systems of corporate CIS aims at introducing some elements of American type mutual fund governance practices, with oversight by independent directors into the Japanese market. At the same time it would appear that alongside the new model based on US mutual funds, traditional Japanese "investment trust" structures would be permitted.

2. Korea

There are two types of CIS: the Securities Investment Trust (SIT), a contractual type that has been in use for many years, and the Securities Investment Company (SIC), a corporate type authorised in December 1998. Fully open-end funds are not yet allowed, but some closed-ended SICs have enjoyed conspicuous growth.

The SITs are still the major players in the Korean CIS market. The SIT is built on a relationship among three parties: the investment trust management companies (ITMCs), the custodians, which are mostly registered banks, and the investors. The ITMCs and the custodians, as parties to the custodial agreement, are responsible for the management and safekeeping of the trust assets, respectively. The ITMCs and the investors are substantive parties to the trust contract. The investors are beneficiaries of the trust assets, while the ITMCs are the trustees vis-à-vis the investors. The ITMCs, in turn, entrust the custodial and other administrative functions to the custodians. The custodians and the investors have little direct legal relationship. The investors, under normal circumstances, may not assert any direct right or claim against the custodians.

Since an SIC is a "paper company" with assets composed entirely of cash or securities, it does business by contracting with independent companies for services such as the management and safekeeping of the assets and sales of the shares. An SIC has a corporate decision-making and executive structure with bodies such as a general meeting of investors, a board of directors, executive directors, supervisory directors and an auditor. The management of the assets of a SIC is undertaken only by a registered SIC manager. The SIC manager establishes a SIC as the sponsor and becomes an actual principal of the contract. A SIC sells its shares through distributors to investors and the investors invest by buying the shares.

The CIS sector in Korea has undergone a serious crisis in recent years. Following the turbulence in the financial markets in late 1997, seven management companies ceased operations, owing to a lack of liquidity, bankruptcy, or capital withdrawal by their parent companies. Following this setback, the CIS sector experienced a strong revival, with CIS assets rising from 100 trillion won at the end of 1997 to 250 trillion won at the end of July 1999, mostly in fixed income funds. However, improper valuation procedure and investment practices in the CIS market, and the ineffectual governance structure of ITMCs,

led to disturbances in the financial system in late 1999. Specifically, bond funds were not marked to market, but were valued at historical prices. This meant that there was a serious risk of insolvency in the sector if the ITMC that managed the funds became insolvent. During 1999-2000, the risk of a large-scale redemption of bond funds grew when investors became aware of the risk of insolvency of ITMCs with large exposures to Daewoo affiliates. The authorities were obliged to take emergency measures and to inject considerable public funds to handle the crisis in the ITC sector. [3]

In addition to the solvency crisis of the past two years, the standard of prudence and investor protection in the Korean CIS sector have fallen short of accepted global norms, further aggravating the structural weaknesses in the Korean CIS sector. Some examples of poor governance practices included the following:

- Since major shareholders of ITMCs are often distributors which are affiliated with large industrial companies, distributors or their parent companies often request operators to buy securities which distributors are underwriting or lend or borrow money on a short term basis at a not-currently-accepted interest rate.

- Even though it is prohibited in the law to transfer securities or trade between investors' fund and a proprietary trading account in an operator, indirect trading has commonly taken place. Some operators have allegedly made commitments in advance about a promised rate of return to investors, even though it is prohibited to do so by the law.

In order to address these structural problems, in early 2000 the Securities and Exchange Act and Securities Investment Trust Business Act were amended to enhance governance structures and introduce global standards in the CIS market. Highlights included in the recent legislative amendment are as follows:

- For ITMCs with total assets under management of more than 6 trillion won, more than half of the total number of directors should be independent directors and the company should establish an audit committee, 2/3 of which must be consisted of independent directors.

- Every ITMC should set internal control standards to ensure that the management and employees comply with the concerned laws and operate their own trust property for the best interest of their beneficiaries.

- Every ITMC should also appoint a compliance officer to examine and monitor its compliance with the internal control standards. In addition, the requirements of minor shareholders to exercise their rights for those ITMCs are eased when compared to other listed corporation.

The Financial Supervisory Service has also established detailed guidelines to promote effective operation of the board of directors, audit committee, and compliance officers based upon the amended laws. For example, the specific roles of compliance officers, the board of directors, senior management, and on-site managers must be clearly defined in the bylaws of ITMCs in order to maximise compliance with the law.

---

54. For a discussion of the problems of the CIS sector in Korea, see OECD, Economic Survey of Korea 2000, pages 182-185. Also see Annex IV on pages 262-288 and Annex V pages 289-292.

E. Other countries

1. Czech Republic

The law recognises two types of CIS. One is an "investment fund", which has a corporate form. The other is a "share fund", which is similar to a contractual form. An investment fund may manage its assets on its own, or it may entrust the management of its assets on the basis of an asset-management agreement to a management company. A management company must receive authorisation in order to manage assets.

The management company or investment fund is obliged to conclude a depository contract with a bank. Only a bank is allowed to operate as a depository. A depository determines whether the activities of an investment company or investment fund are in compliance with both the Act and the statute of the fund. An auditor examines annual financial statements relating to investment funds, investment companies and "share funds" it manages. The full text of an auditor's report is a part of the annual report which an investment company or an investment fund shall publish.

A management company or an investment fund is obliged to prepare internal organisational and operational guidelines as well as to devise procedures for internal review. Procedures must also include safeguards to prevent the use of assets of the funds for trades on the management company's account and for dealing with conflicts of interests between management companies and the funds. Each management company must have a compliance officer. There is also the Code of Ethics of the Union of Management Companies (the self-regulatory body) setting forth the fundamental principles of ethical behaviour in the area of collective investment.

2. Turkey

Turkey uses an open-end contractual type CIS. (There are also closed-end investment funds of a corporate type.) Banks, other financial institutions, insurance companies, employee funds, or pension funds are authorised to found a CIS. A founder, who has oversight responsibility, is responsible for the protection and safekeeping of assets of a CIS. Assets of a CIS are held separately from those of the founder. The portfolio manager is named by the founder under a portfolio management contract. The portfolio manager can be either a portfolio management company or a financial intermediary.

There is no requirement for an independent custodian, but the assets of a CIS must be deposited in the central depository institution named "Istanbul Stock Exchange Settlement and Custody Bank". To assure that CIS operators act in the interests of the investors, organisational structure and internal control mechanisms are examined and controlled at the registration. Follow-up monitoring continues by online connections.

3. Mexico

Corporate type CIS are the predominant form. Two kinds are found: 1) an ordinary fund that invests primarily in transferable securities and 2) a special fund for debt instruments and money market instruments. CIS operators are independent corporate entities organised with the sole purpose of CIS portfolio management, operational services and shares distribution. Securities brokerage firms and commercial banks may also assume overall responsibility for management and performance of the functions of the CIS. Safekeeping of CIS assets (non-government securities) is accomplished by a securities depository institution (INDEVAL). The Bank of Mexico carries out custody of government securities. Decision-making concerning CIS investment strategies and portfolios composition is centred in

their investment committees, whose members are appointed in special stockholders meetings to guarantee independence of the CIS investment decision-making process from the trading process carried out by their operators.

To ensure fairness in the daily valuation process, Mexican law requires that those calculating NAV should be independent from the CIS themselves, their operators and issuers of securities held in their portfolios. In addition, to avert conflicts of interest, the supervisory authority prohibits CIS from buying securities owned or managed by any other member of the same financial group to which the operator belongs.

F. Preliminary Conclusions[4]

The OECD countries have used a variety of institutional mechanisms to enable the CIS sector to provide investor protection. The fact that very few countries have had any crises in the CIS sector and that CIS have become major repositories of wealth would seem to suggest that existing governance mechanisms are adequate and that public confidence is high. Also, the fact that fraud and misallocation of funds occurred in several European countries before the introduction of adequate legal frameworks and that a serious systemic crisis arose in Korea, where international standards were not effectively enforced, provides evidence that such safeguards are needed. At the same time, once a body of acceptable standards has developed and governance structures mature to the point that those assigned an oversight role can compel participants to apply those standards, it becomes very difficult to demonstrate that any particular system provides better investor protection than others.

The internal governance procedures are the first step in the entire process by which the activities of CIS are subjected to successive layers of monitoring. Other crucial elements in the process are:

- *Industry self-regulation*. In many countries industry associations have developed codes of conduct and exercise some self-regulatory functions, such as reviewing promotional material. In many cases, self-regulatory bodies take the lead in promoting and enforcing Codes of Conduct.

- *Official Supervisory Oversight*. By prior authorisation and periodic review, the adequacy of internal monitoring procedures and conformity with standards is assessed.

- *Scrutiny by the market*. Adequate disclosure enhances the capability of investors to undertake independent scrutiny. In cases where inadequate governance procedures are in place or where standards are not observed, investors can take legal action or lodge complaints with regulators. Perhaps, most importantly, any practice that leads to diminished returns to investors will lead to a decline of funds under management. Particularly in advanced competitive markets, this is the sanction most feared by CIS operators.

When considering the extent to which the market can provide effective monitoring to the operators of CIS, two basic considerations arise: the degree to which there is active competition among suppliers of CIS services and the adequacy of information to investors. In most markets competition is growing rapidly. In the United States, diversification of distribution channels has been occurring for more than two decades. Competition among distribution sources is also beginning to accelerate in Europe. Other things being equal one would expect market competition to be a powerful factor aligning the interests of the investment manager and CIS promoters with those of investors.

---

55. To be revised in light of the Committee's discussion on 9-11 October.

Experience suggests that competition encourages fund organisers to go beyond the legal requirements in matters related to investor protection. The authorities may fix maximum sales charges, but once the basic institutional framework is in place, competitive pressures will frequently drive the industry to reduce fees further. Similarly, in order to attract customers and explain their investment policies and results to investors, most funds provide more than the minimum required information.

The availability of information, aided by advances in technology, has been crucial in empowering investors. Once mandatory disclosure requirements are fulfilled, the information-processing sector can enhance the value of this information. The traditional means of communicating such information has been through the specialised financial press, but information technology such as the Internet is increasingly important.

At a minimum one can say that internal governance and official regulation should be effective in enforcing standards and preventing conflicts of interest while making it possible for market scrutiny to provide an even stronger means of redressing the initial imbalance between the fund promoter and the investor. Beyond simply enforcing a set of standards, one can say the internal governance systems should function as part of a wider process in which the operators of the CIS (usually the board of directors of the investment management company) interact with the system of internal controls in a competitive market. This process will provide strong incentives for the CIS operator, not merely to avoid outright abuses of agency relationships but more broadly to conduct the business of the CIS in the interests of the investors.

VI. Other Governance–related Issues

Most of this note has been concerned with structures for investor protection. However, in addition to fulfilling this task, the governance regime must create an institutional setting in which it is possible for the CIS operator to formulate and execute an investment strategy, communicate that strategy to investors and periodically adjust behaviour based on experience. This section briefly highlights other governance-related questions.

A. Investment Style, Performance and Cost

Beyond simply preventing fraud or conflict of interest, an effective governance structure should make the investment manager accountable to investors for performance and costs. CIS are increasingly capable of executing very refined investment strategies, (*e.g.* value, growth, technology etc) which require varying degrees of analysis, trading activity and discretion by the portfolio manager. For example a "value" index fund may automatically purchase shares in all companies displaying certain characteristics and may be obliged to sell shares when a company's ratio passes certain limits, *e.g.* when the price earnings ratio rises above a threshold or the dividend yield falls below a threshold. Within the norms defined by the fund's investment objective, the investment management company will grant the portfolio manager leeway in deciding how far the portfolio will be allowed to deviate from the benchmark (the "tracking error"). The investment style may include visits to companies to make qualitative decisions concerning the capacity of management. The choice of style must be reviewed by the directors of the investment management company and in some cases by others responsible for fund governance.

CIS have been criticised on the grounds that most actively managed funds have often not performed as well as benchmark indices, suggesting that the fund manager is not adding any value. At the same time, many analysts have concluded that the portfolio holdings of a large part of the fund industry cannot be closely related to the investment styles described in their prospectus, *i.e.* that the same securities may be held in portfolios described as having "growth" or "value" styles. In the same vein, some industry critics

contend that expenses have remained high and in some cases have become less transparent despite the fact that technology has reduced trading costs and that economies of scale should have made very large cost reductions possible.

It is a reasonable question how far the internal governance regime, as opposed to market scrutiny, can deal with these issues. It is relatively easy to determine whether a portfolio manager is observing certain restrictions (for example, holding a specified portion of the portfolio in investment grade bonds or shares of companies within a given industry). It is harder to determine whether a portfolio manager has effectively carried out a given portfolio strategy. Similarly, it can be observed that expense ratios and other charges vary widely, even among funds that have similar mandates.

Arguably, once the proper legal and governance structures and an adequate regulatory and disclosure framework are in place, scrutiny in a competitive market is the most powerful force working to protect investors. As long as the investment manager has disclosed the investment strategy, including the expected amount of trading activity that will be used to achieve that objective, investors can decide whether they wish to pay for additional analysis and active portfolio selection. The fact that index-tracking funds that adopt passive portfolio selection are gaining in popularity suggests that many investors are concluding that portfolio managers have on balance not been adding value. Alternative investment products may eventually out-perform CIS and thereby gain a large share of the retail market now controlled by CIS.

B. Corporate governance activities by CIS

Thus far the discussion has centred on the organisation and governance of investment funds. However, collective investment instruments are becoming major holders of equity and thus must decide whether and how to exercise the ownership and governance rights resulting from this ownership position. CIS are mandated to seek to maximise the value to investors while it is possible for investors to liquidate positions at all times and they compete for funds partly on the basis of superior portfolio selection skills. Thus one would expect them to be comparatively "active portfolio managers", who try to enhance the value of their portfolios by adjusting their holdings in accord with their assessment of corporate valuations. This can be contrasted with other institutional investors who tend to trade less frequently and try to add value by active dialogue with management, a practice characterised as "investor activism" in corporate governance. Thus, on balance, one would expect a CIS to trade more actively and to be less "activist" than a pension fund. At the same it should be recognised that buying and selling by CIS is part of the overall process whereby corporate management is made accountable to investors. [5]

One factor that may dissuade European CIS from active governance is the provision of article 25 of the UCITS Directive which states that no authorised UCITS shall invest in shares carrying voting rights which make it possible to exercise significant influence over the management of the issuer. Although this could be read as precluding all CIS participation in corporate governance, most market participants do not interpret it in this way.

Preliminary evidence indicates many collective investment companies have decided that some degree of monitoring of the governance practices of companies in their portfolio may be beneficial. Thus, some funds have policies about the composition of boards of directors or dividend payment policies and regularly cast votes on related issues. Many CIS have taken pains to develop information channels, such as shareholder information and voting services, that make it possible to establish policies on governance and

---

56. For an analysis of how various investment styles contribute to the process of corporate monitoring, see "Shareholder Value and the Market in Corporate Control," Financial Market Trends (March 1998.).

to vote systematically. At times, CIS delegate their voting rights to custodians with specific instructions as to how shares are to be voted. This being said, there is controversy within the industry as to what degree of activism is desirable. For example, in France some institutional investor associations have proposed codes of conduct that would encourage more active CIS participation in corporate governance. In the United Kingdom, an officially sponsored commission (the Myner Commission) is examining the corporate governance activities of all institutional investors including CIS.

In addition to general equity funds where governance related activities are marginal, there are a number of funds that explicitly pursue "active value" investment styles, *i.e.* of producing returns for investors by taking relatively large positions and engaging in active dialogue with the management of some companies and urging the targeted companies to take specific actions.

C. Ethical and Environmental Funds

One final group of issues that merits some comment is "ethical and environmental" funds. As part of their investment objectives, such funds have non-economic objectives such as only investing in companies that pursue desired policies with regard to a defined set of ethical and environmental issues. Subject to these constraints, these funds seek to obtain high returns for investors. This market segment is well established in the United States and is expanding rapidly in Europe. The advent of funds having non-economic as well as economic objectives opens a range of issues concerning portfolio selection as well as the degree to which the fund wishes to pursue a policy of active dialogue with management, based on non-economic concerns.

D. International trade in Services/Market access

A significant internationalisation of the CIS industry has already occurred. Asset managers from the major OECD regions have become established in other markets and/or have made strategic acquisitions in order to be able to gain strategic footholds in the fund management sectors of other countries. However, cross border trade in CIS has not progressed as rapidly as other aspects of CIS business. While the UCITS Directive has greatly enhanced the possibility to conduct CIS business on pan-European scale, the European scene is still characterised by a maze of EU wide and internal rules governing funds in which some funds can be marketed throughout Europe while other can be sold only in their home jurisdiction. Thus, it is not sure whether Europe has achieved a market of continental scope comparable to that of the United States. At this time, revisions to the UCITS Directive have been proposed that would broaden the range of funds available for approval as UCITS while simplifying procedures for gaining approval in all EU states. Outside of Europe, relatively little cross border trade in CIS products takes place, partly due to difficulties in meeting specifications for products introduced in other markets.

TABLE I – FINANCIAL ASSETS OF INVESTMENT COMPANIES[(1)]

Tableau I. **ACTIFS FINANCIERS DES SOCIETES D'INVESTISSEMENT[(1)]**

Billion US Dollars — *Milliards de dollars EU*

	1990	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998** [p]	
Australia	18.8	20.4	19.6	24.3	26.2	31.8	43.7	50.4	59.4	Australie
Austria	14.3	15.1	15.1	18.3	23.0	33.0	39.4	44.9	65.2	Autriche
Belgium	25.6	30.9	38.3	54.3	59.8	69.0	74.7	82.2	..	Belgique
Canada	30.4	44.0	53.7	82.5	94.1	107.0	143.0	174.1	196.7	Canada
Czech Republic	..	..	..	1.0	1.2	1.2	2.2	1.3	..	République Tchèque
Denmark	3.7	3.8	3.7	4.7	5.5	6.5	9.4	13.1	19.7	Danemark
Finland	0.1	0.1	0.1	0.6	1.1	1.2	2.4	3.1	5.7	Finlande
France	393.1	449.4	471.8	508.3	549.2	574.3	586.5	564.5	714.6	France
Germany	147.2	173.0	172.8	228.4	293.6	369.1	411.8	475.2	647.1	Allemagne
Greece	..	..	..	4.0	6.1	11.0	16.2	26.5	33.6	Grèce
Hungary (2)	_	_	0.1	0.2	0.3	0.4	0.7	1.2	1.5	Hongrie (2)
Iceland	0.3	0.2	0.2	0.2	0.3	0.3	0.5	0.7	1.4	Islande
Italy	41.9	48.8	41.3	64.6	79.9	80.0	129.1	209.3	409.6	Italie
Japan	390.0	373.8	407.4	503.6	481.2	500.0	448.9	665.3	370.7	Japon
Korea	34.1	37.3	49.5	70.3	78.6	93.1	96.5	61.4	..	Corée
Luxembourg (3)	94.1	132.9	203.6	276.0	313.6	359.0	348.1	428.1	654.6	Luxembourg (3)
Mexico	20.4	26.3	15.9	34.1	10.9	7.3	10.0	12.6	11.9	Mexique
Netherlands	32.1	33.9	36.5	48.8	55.1	63.0	66.5	68.9	62.6	Pays-Bas
Norway	2.6	2.8	2.2	5.0	5.5	7.2	10.3	13.4	11.4	Norvège
Poland	..	..	_	0.4	0.6	0.3	0.5	0.5	..	Pologne
Portugal	3.0	6.7	8.3	10.0	16.5	16.4	16.9	21.4	28.2	Portugal
Spain	15.9	44.9	57.9	74.6	88.5	103.2	144.2	179.2	242.2	Espagne
Sweden	38.8	41.6	33.4	35.6	40.1	51.3	60.1	76.7	..	Suède
Switzerland	18.6	19.5	19.3	33.9	38.6	44.4	47.4	53.2	70.2	Suisse
Turkey	0.5	0.3	0.4	1.1	0.7	0.6	1.2	1.0	..	Turquie
United Kingdom	125.8	142.1	137.7	191.1	201.5	238.1	310.7	344.3	386.0	Royaume-Uni
United States	1154.6	1375.7	1625.5	2051.1	2198.1	2732.4	3378.2	4187.5	5087.7	Etats-Unis
Total	**2605.8**	**3023.7**	**3414.1**	**4327.1**	**4669.8**	**5500.8**	**6399.1**	**7760.0**	**9079.9**	**Total**
of which EU	*899.3*	*1084.4*	*1189.3*	*1488.8*	*1698.9*	*1930.9*	*2166.2*	*2474.1*	*3280.4*	*dont UE*

(1) Open-end and closed-end investment companies.
(2) Total assets for 1992 and 1993.
(3) Total assets.

(1) Sociétes d'investissement à capital variable et à capital fixe.
(2) Total des actifs pour 1992 et 1993.
(3) Total des actifs.

TABLE II – FINANCIAL ASSESTS OF INVESTMENT COMPANIES AS PER CENT OF GDP[1]

Tableau II - **ACTIFS FINANCIERS DES SOCIETES D'INVESTISSEMENT[1]**

AS A PERCENTAGE OF GDP / EN POURCENTAGE DU PIB

	1990	1991	1992	1993	1994	1995	1996	1997	1998 p	
Australia	6.4	6.9	6.7	8.5	8.0	9.0	11.1	12.8	16.9	Australie
Austria	9.0	9.1	8.1	10.0	11.8	14.2	17.3	21.8	30.7	Autriche
Belgium	13.0	15.3	17.0	25.4	25.7	25.2	27.8	33.9	..	Belgique
Canada	5.3	7.5	9.4	14.9	17.1	18.7	24.1	28.7	33.8	Canada
Czech Republic	..	..	..	3.0	2.9	2.4	3.8	2.4	..	République Tchèque
Denmark	2.7	2.8	2.5	3.4	3.6	3.6	5.1	7.7	11.3	Danemark
Finland	0.1	0.1	0.1	0.8	1.1	0.9	1.9	2.6	4.5	Finlande
France	32.9	37.4	35.7	40.7	41.3	37.4	38.1	40.5	49.8	France
Germany	9.0	10.1	8.8	11.9	14.3	15.3	17.6	22.7	30.3	Allemagne
Greece	..	..	..	4.4	6.2	9.5	13.1	22.1	27.9	Grèce
Hungary (2)	..	..	0.2	0.5	0.8	1.0	1.6	2.7	3.2	Hongrie (2)
Iceland	4.2	3.5	2.4	3.2	4.5	4.2	6.6	9.6	16.5	Islande
Italy	3.8	4.2	3.4	6.6	7.9	7.4	10.6	18.3	34.9	Italie
Japan	13.1	11.0	11.0	11.8	10.3	9.7	9.8	15.9	9.8	Japon
Korea	13.4	12.7	16.1	21.1	20.6	20.4	19.9	13.9	..	Corée
Luxembourg (3)	928.9	1218.6	1613.5	2149.2	2151.4	2076.3	2051.3	2716.4	3401.8	Luxembourg (3)
Mexico	7.8	8.4	4.4	8.5	2.6	2.5	3.0	3.1	2.9	Mexique
Netherlands	11.3	11.7	11.3	15.6	16.3	15.8	16.8	19.0	16.6	Pays-Bas
Norway	2.3	2.4	1.8	4.3	4.5	4.9	6.5	8.7	7.8	Norvège
Poland	..	..	..	0.5	0.6	0.2	0.4	0.4	..	Pologne
Portugal	4.3	8.6	8.8	12.0	18.8	15.6	15.6	21.2	26.7	Portugal
Spain	3.2	8.5	10.0	15.6	18.3	18.4	24.8	33.7	43.8	Espagne
Sweden	16.9	17.4	13.5	19.2	20.2	22.2	23.9	33.7	..	Suède
Switzerland	8.1	8.4	7.9	14.3	14.8	14.4	16.0	20.8	26.5	Suisse
Turkey	0.4	0.2	0.2	0.6	0.6	0.3	0.6	0.5	..	Turquie
United Kingdom	12.9	14.0	13.1	20.3	19.8	21.5	26.9	26.8	28.4	Royaume-Uni
United States	20.8	24.1	27.0	32.3	32.7	38.8	45.7	53.5	61.8	Etats-Unis

(1) Open-end and closed-end investment companies.

(2) Total assets for 1992 and 1993.

(3) Total assets.

(1) Sociétes d'investissement à capital variable et à capital fixe.

(2) Total des actifs pour 1992 et 1993.

(3) Total des actifs.

ANNEX I – INTERNATIONAL STANDARDS OF INVESTOR PROTECTION, 1997-1994

	OECD's Standard Rules(1971)	EU's UCITS Directive(1985)	IOSCO's Principles(1994)
STRUCTURE			
Operator/Manager			
- Capital Adequacy	- A minimum capital of the equivalent of 100,000 to 125,000 units of account(Rule 17)	- Sufficient financial resources or paid-up capital(Article 5 & 12)	- Adequate financial resources(3.3)
- Other Eligibility Standards	- Not covered	- Not covered	- Sufficient human and technical resources(3.2)
- Standards of Conduct	- Not covered	- An operator may not engage in activities other than the management of a CIS(Article 6 & 13)	- Honesty and fairness, diligence and effectiveness, operator specific powers and duties, and compliance (3.1, 3.4~3.6)
- Protection of Investors in the Case of Change of Management	- Required(Rule 21)	- Required(Article 11 & 18)	- Not covered
Depository/Custodian			
- Appointment of Independent Custodian or Depository	- Not required(Rule 18)	- Required(Article 7, 10, 12 & 17)	- Required(2.1 & 2.3)
- Liability of Custodian or Depository for any losses suffered by the Investors	- Not covered	- Required(Article 7, 9, 14 & 16)	- Required(2.1)
- Financial and Other	- Not covered	- Required(Article 8 & 15)	- Required(2.2)

Resources as Eligibility Standards - Standards of Conduct	- Not covered	- A depository must ensure that the sale, issue, repurchase, redemption, valuation and cancellation of units are carried out in accordance with the law and the fund rules(Article 7 & 14)	- Not covered
Investment Adviser/Distributor	- Any person selling shares of a CIS shall have an acceptable standard of professional qualification.(Rule 32)	- Not covered	- The principles that govern eligibility and conduct of an operator should also apply to a delegate (i.e. an investment adviser). An operator should take responsibility for the delegation, ensure ongoing monitoring, and provide all reasonable means to permit a delegate to fulfil its obligations. (4.1~4.6)
Conflicts of Interests	- Directors of the CIS, the trustee, the management company or the distribution company as well as all person who are liable to come under the influence of any of them shall not engage in transactions with the CIS itself, the management company or the distribution company.(Rule 23)	- Not covered	- Conflicts of interests may be controlled by the duty of an operator to act in best interests of investors and the power of the regulatory authority to impose sanctions for self-dealing.(6.1~6.3)
Supervision - Authorisation - Supervisory Authority	- Not covered - The supervisory authority should ensure that there is adequate official surveillance.(Rule 34)	- Required(Article 4) - The Member State shall designate the authorities which must be granted all the power to carry out their task.(Article 49)	- Required(5.1) - The regulatory authority should have means or powers to investigate conduct relating to CIS and to protect investors' interests.(5.2~5.3)

Investor Rights	- Not covered	- Not covered	- The regulatory regime should provide investors with certain rights to withdraw funds from the CIS within a reasonable period and to participate in significant decisions concerning the CIS.(9.1~9.3)
VALUATION & PRICING			
Valuation - Price of Unit	- It shall equal the net asset value per share and be calculated at least once a month.(Rule 24 & 25)	- The rules for calculating the price of the units must be laid down in the law, in the fund rules or in the investment company's instruments of incorporation.(Article 38)	- It should be calculated according to the net asset value on a regular basis in accordance with accepted accounting practices and be published through the appropriate method. Assets must be valued according to their market price.(7.1 & 7.3)
- Method and Procedure of Asset Valuation	- It must be satisfactory to the supervisory authority, which shall be verified periodically by an independent auditor.(Rule 19)	- It must be laid down in the law, in the fund rules or in the investment company's instruments of incorporation.(Article 38)	- It must be laid down in the law or a CIS's rules or its public disclosure documents.(7.1)

Purchasing and Redemption of Units - Redemption of Units - Suspension of Redemption Right - Settlement	- It shall be at the option of the investor.(Rule 26) - Redemption shall not be suspended unless exceptional circumstances prevail under which it is, in particular, not reasonably practical to ascertain the value of the assets of the CIS or to dispose of them.(Rule 27) - Payment shall be made in cash in the currency unless redemption by means of portfolio securities is authorised by the supervisory authority.(Rule 26) - Payment shall be made no later than 5 to 30 days after receipt of the request for redemption.(Rule 26)	- Units must redeemed at the request of any unit-holder.(Article 37) - Redemption may temporarily be suspended in exceptional cases where circumstances so require and suspension is justified having regard to the interests of the unit-holders.(Article 37) - Not covered	- Units must redeemed at the request of any investor.(7.2) - Redemption may only be suspended on a temporary basis and any such suspension must be in accordance with the procedures provided for by the law or the CIS rules and must be in the interests of investors.(7.2) - Purchase and redemption of units may be done in cash, or in certain cases when it may be by way of securities.(7.2) - Purchase and redemption orders are to be settled as soon as possible.(7.2)
Distribution of the Income	- Income and realised capital gains shall be distributed to its participating investors in accordance with the provisions in its prospectus. Unrealised capital gains may not be distributed.(Rule 28)	- The distribution or reinvestment of the income shall be effected in accordance with the fund rules or the investment company's instruments of incorporation.(Article 39)	- The distribution or reinvestment of the income must be effected in accordance with the law and the CIS rules.(7.3)

INVESTMENT & BORROWING LIMITATION			
- Investment Restrictions	- Not covered	- The investments must consist solely of transferable securities listed or money market instruments dealt in on regulated markets.(Article 19)	- Limitations imposed on CIS should indicate the extent of investment in transferable securities not listed on a regulated market, transferable securities issued by the same issuer, derivative instruments and other CIS.(8.1)
- Portfolio Diversification	- A CIS shall not invest more than 5 to 15 % of its assets in the securities of any one issuer.(Rule 8) - A CIS shall not invest more than an aggregate of 5 to 15 % of its assets in securities issued by other CIS. (Rule 10)	- A UCITS may not invest more than 5 to 35% of its assets in transferable securities issued by the same body.(Article 21) - A UCITS may invest no more than 10% of its assets in the units of CIS.(Article 24)	
- Borrowing Limitation	- A CIS shall never have outstanding borrowings in an amount exceeding 20 % of its total assets.(Rule 14)	- A UCITS may be authorised to borrow up to 15% of its assets on a temporary basis. Neither an investment company nor a management company or depository may borrow.(Article 36)	- Limitations imposed on CIS should prescribe the extent of borrowing permitted, other than on a temporary basis, and the extent to which securities lending transactions may be entered into by the CIS.(8.2)
- Other Transactions	- A CIS shall not sell securities short.(Rule 13) - A CIS may write call options for securities in its portfolio only to the extent that it is actually the owner of the securities in question. It shall not write call options for its own shares.(Rule 15) - A CIS shall not issue warrants, rights or options which entitle their holders to purchase its shares.(Rule 29)	- Neither an investment company nor a management company or depository may grant loans or carry out uncovered sales of transferable securities.(Article 36, 41 & 42)	
- Liquidity	- A high percentage of the assets of a CIS(75 to 90 %) shall be in readily reasonable form.(Rule 16)	- Not covered	- Not covered

MARKETING			
Prospectus			
- Publication	- Required(Rule 2)	- Required(Article 27)	- Required(10.1)
- Contents	- It shall contain a description of the general aims and objectives of the CIS, information concerning its legal structure and operating rules and regulations, all information on persons concerned with the operation and sales and redemption charges and management fees.(Rule 2, 3 & 4)	- It must include the information necessary for investors to be able to make an informed judgement of the investment proposed them. It shall contain at least the information provided for Schedule A annexed to this Directive.(Article 28)	- It must include all material information which investors would reasonably require and expect to find to make an informed investment decision. Minimum contents include information concerning the legal constitution of the CIS, information on the operator and the custodian, procedures for purchase, redemption, and pricing of units, relevant financial information, the investment policy, fees and charges and so on.(10.1)
- Updating	- It shall comprise or be accompanied by an up-to-date financial statement concerning the CIS.(Rule 2)	- Its essential elements must be kept up to date.(Article 30)	- It must be kept up-to-date to take account of any material changes affecting the CIS.(10.1)
Advertising	- Shares of CIS shall be advertised only if admitted to public sale. The supervisory authority should ensure that such advertising is not false, misleading or reckless.(Rule 31)	- Any UCITS may advertise its units in the Member State in which they are marketed.(Article 44) - If a UCITS proposes to market its units in a Member State other than that in which it is situated, it must first inform the authorities.(Article 46)	- Advertising must normally be undertaken after all the necessary authorisations have been granted to permit the CIS to market to the investing public. There must be nothing in advertising of a CIS which is inconsistent with the prospectus. (10.3)

DISCLOSURE			
Regular Reporting - Frequency - Contents **Other Information**	- At least once every year(Rule 5) - A statement of income and expenses; a statement of assets, liabilities and total outstanding shares; a detailed list of securities held, bought or sold. (Rule 5 & 6) - A CIS shall make available for publication and to any person on demand, free of charge, the net asset value per share, the sales price per share and the redemption price per share.(Rule 7)	- Both annual and half-yearly (Article 27) - A balance-sheet, a detailed income and expenditure account, a report on the activities of the financial year and so on.(Article 27, 28, 32 & 33) - A UCITS must make public in an appropriate manner the issue, sale, repurchase or redemption price of its units at least once or twice a month. (Article 34)	- Either on an annual or semi-annual basis(10.2) - Accounting information relevant to the CIS and a statement concerning the interests in the CIS that have been redeemed or repurchased over the relevant period.(10.2) - Information on the system for pricing, valuation and associated procedures must be made available to investors on requests. The net asset value per unit should be published through the appropriate methods.(7.1)

ANNEX II – IOSCO STATEMENTS RELATED TO INVESTOR PROTECTION, 1997-2000

Supervision Principles(1997)	Report on Conflicts of Interests(2000) and Guiding Principles in Valuation(1999)
1. Conduct of Business ***1.3 Churning*** Ensure that the CIS operator has procedures in place to guard against trading of the CIS portfolio which is excessive in light of the CIS stated objectives. ***1.4 Cash Commission Rebates*** Ensure that an operator does not benefit from unauthorized rebates of brokerage commission from transactions made on behalf of a CIS ***1.5 Soft Commission Arrangements*** Confirm that the services which are subject to a soft commission agreement are for the benefit of a CIS, have been disclosed to investors, and that transactions carried out are done in accordance with best execution standards. ***1.6 Inducements*** Ensure that an operator (or its agents) does not offer or accept any inducement which is likely to significantly conflict with the duties owed by the operator to its customers.	There is a wide variety and complexity in the types of transactions that are likely to give rise to conflicts of interests. However, those activities of a CIS operator which are likely to give rise to conflicts of interests are divided into two broad areas: ***a. investment selection activities*** - principal transactions involving a CIS and its affiliated parties; - transactions using affiliated party intermediaries; and - joint transactions with affiliated parties. ***b. other CIS management activities*** - fees and charges levied by the CIS operator; - use of CIS assets for marketing the CIS; - employee remuneration and employee transactions on own account; - selection of directors, custodians and - depositories who are not independent of the CIS operator; and - CIS operator's trading on own account.
2. Connected Party Transactions Ensure that any transactions undertaken on behalf of a CIS with a connected party of the operator do not conflict with the operator's obligations to act in the best interests of the CIS. ***2.1 Functional Separation of Group Operations*** Where an operator is connected to a company or group of companies in which non-fund management activities are carried out, confirm that	The range of regulatory mechanisms that are used by member jurisdictions to address conflicts of interests include: - general duty imposed on the CIS operator to act in the best interests of CIS investors; - review/oversight of a CIS operators' activities by an independent third party; - direct prohibitions of transactions which are likely to give rise to conflicts of interests;

appropriate protective arrangements, including "Chinese walls", are in place to limit and disclose any conflicts of interest. ***2.2 Use of Connected Brokers and Banks*** Ensure that where an operator places CIS transactions through a connected broker, such transactions are carried out at arms' length and transaction execution is consistent with best execution standards. Ensure that where cash forming part of the CIS assets is deposited with a connected person to the operator, interest is received on the deposit at a rate not lower than the prevailing commercial rate for a deposit of that size and term. Similarly if the CIS borrows from a connected person of the operator, ensure that the interest charged and any fees levied in connection with the loan are no higher than the prevailing commercial rate for a similar loan ***2.3 Underwriting and Participation in IPO's*** Establish that an operator's underwriting procedures and arrangements are not detrimental to customers and that all underwriting which is carried out is in the best interest of the CIS. ***2.4 Personal and House Account Dealing*** Ensure that a CIS operator has procedures in place to ensure that the operator's employees (as appropriate) do not make transactions on their own account, or for the account of the operator itself, that may conflict with the operator's obligations to the CIS.	- review and/or approval of certain transactions by the regulator or an independent third party where they raise conflicts of interests; - disclosure of information relating to conflicts of interests to investors and/or regulators; - detailed standards and procedures that must be followed by a CIS operator; - restrictions relating to certain conduct; - use of Codes of Conduct that deal with conflicts of interest situations; and - regulator's power to monitor and impose sanctions in appropriate cases. The regulatory responses that can be used to address those conflicts of interests are also varied in nature and can be used in any combination depending on the regulatory framework and structures within which they are implemented.
3. Valuation of CIS Assets Ensure that all the property of a CIS is fairly and accurately valued and that the net asset value of the CIS is correctly calculated. ***3.1 Calculation of the Net Asset Value*** The net asset value (NAV) of a CIS is calculated by dividing the total value of the investments in a CIS by the number of units in issue, plus / minus adjustments for accrued fees, expenses and other liabilities. Confirm that the operator has systems in place to ensure that calculations of the NAV are correct at each valuation point ***3.2 Valuation of Investments*** Ensure that all the property of a CIS is valued at each valuation point. If a CIS is required to value investments at market value then the source of the pricing information, usually a third party supplier, should	- Valuation to be determined in good faith; - CIS to be valued on a per unit/share basis based on the CIS's asset value, net of allowable fees and expenses previously disclosed to investors, divided by the number of outstanding units/shares; - CIS to be valued at regular intervals appropriate to the nature of scheme property; - CIS to be valued in accordance with its constitutive and offering documents; - Valuation methods to be consistently applied (unless change is desirable in the interests of investors); - Valuation and pricing basis adopted to be disclosed to investors in the CIS

be checked for accuracy and timeliness. This can be carried out by comparing the prices used by a CIS with another source of the same information. ***3.3 Collection of Income on Behalf of a CIS*** It may be a custodian's responsibility to ensure that all income has been collected. Confirm that arrangements are in place to ensure income has been received and, if not, to be able to follow up with the companies in question as to why the income is outstanding.	offering documents. - Incoming, continuing and outgoing investors to be treated equitably such that purchases and redemption of CIS interests are effected in a non-discriminatory manner;

ANNEX III - SUMMARY OF REPLIES TO IOSCO QUESTIONNAIRE

(supplemented by replies to OECD Secretariat)

1. LEGAL STRUCTURE

	What kinds of legal structure of CIS are found? (1)	Who is responsible for the conduct of the CIS?	Who has oversight responsibility?
Australia	Trust	Responsible Entity	Independent directors or Compliance committee of Responsible Entity
Austria			
Belgium	Investment company or Contractual fund	Board of directors of Investment company(Management company)	Board of directors of Investment company(Management company) or Depository
Canada	Investment company or Trust	Investment manager	Board of directors of Investment company or Trustee
Czech Republic	Investment company or Contractual fund	Management company	Board of directors of Investment company or Depository
Denmark	Contractual fund	Board of directors of CIS or Management company	Board of directors of CIS
Finland			
France	Investment company or Contractual fund	Management company	Board of directors of Investment company or Depository
Germany	Contractual fund	Management company	Depository
Greece	Investment company or Contractual fund	Management company	
Hong Kong, China	Investment company or Trust	Investment manager	Custodian or Trustee

Hungary			
Iceland			
Ireland	Investment company or Trust	Board of directors of Investment company or Management company	Custodian or Trustee
Italy	Investment company or Contractual fund	Management company	Depository
Japan	Investment company or Contractual fund	Management company	Board of directors of Investment company
Korea	Investment company or Contractual fund	Management company	Board of directors of Investment company(Management company)
Luxembourg	Investment company or Contractual fund	Board of directors of Investment company or Management company	Board of directors of Investment company or Depository
Mexico	Investment company	Management company	
Netherlands	Investment company or Trust	Management company	
New Zealand	Trust	Management company	Trustee
Norway			
Poland			
Portugal	Contractual fund	Management company	
Singapore	Trust	Management company	Trustee
Slovakia			
Spain	Investment company or Contractual fund	Board of directors of Investment company or Management company	Board of directors of Investment company
Sweden	Contractual fund	Management company	
Switzerland	Contractual fund	Management company	Custodian
Turkey	Investment company or Contractual fund	Board of directors of CIS	Founder of CIS
United Kingdom	Investment company or Trust	Board of directors of Investment company or Management company	Board of directors of Investment company, Trustee or Depository
United States	Investment company	Board of directors of Investment company	Board of directors(Independent directors) of Investment company

2. INFRASTRUCTURE FOR MINIMIZING CONFLICTS OF INTERESTS

	What legal and structural features are found to assure that CIS operators act in the interests of the investors? (3)	Does there exist a statutory code of conduct enforceable for all CIS operators? (5)	Does there exist a non-statutory code of conduct enforceable for all CIS operators?	Are there any legal restrictions as to connected party transactions?	Is disclosure to investors used to deal with conflicts of interest? At what interval is such disclosure made?
Australia	Either at least half of directors should be independent (external) or a compliance committee with a majority of external members should be designated.	No		Yes	Yes
Austria					
Belgium	In order for a CIS to be managed in the exclusive interest of the participants, an adequate organisation is required guaranteeing an autonomous management of the CIS concerned.			Yes	Yes, in the prospectus, annual, and semi-annual report.
Canada	CIS operators are required to exercise their power honesty, in good faith and in the best interest of the mutual fund.	No		Yes	Yes
Czech Republic	A written internal organisational and working guidelines are required to restrict conflicts of interests. An compliance officer should be appointed.	No	Yes	Yes	
Denmark	The majority of board members must be independent of the depository company.				Yes, in the annual report
Finland					
France	Internal controls should be put in place to reduce the risk of conflict of interests and a compliance officer who is responsible for it must be designated.	Yes		Yes	Yes, in the annual report

Germany	A proper business organisation in order to monitor risks must be put in place. The organisational structure and the envisaged internal control mechanisms are examined at the licensing procedure.	Yes		Yes	Yes, in the annual and semi-annual report
Greece	Internal controls must be in place to avoid conflicts of interest.	Yes		No	No
Hong Kong, China	A designated compliance officer to maintain sufficiently detailed compliance procedures should be appointed.	Yes		No, but these transactions may only be carried out on arm's length terms and not more than 50% of the CIS's transactions in value in a year.	Yes
Hungary					
Iceland					
Ireland	CIS operators are required to act independently and solely in the interests of unit-holders.	No		Yes	Yes, in the prospectus
Italy	Internal procedures must be implemented to minimise the risk of conflicts.	Yes		No, provided that equal treatment of the CIS is ensured.	Yes
Japan	Specific internal control measures to avoid conflicts must be implemented.	Yes		Yes	Yes, in the prospectus
Korea	Internal control system is required to ensure that management act in accordance with its responsibilities to investors. A compliance officer should be appointed.	Yes	Yes	Yes	Yes, in the semi-annual report

Luxembourg		No		No, but these transactions have to be concluded on an arms length basis.	No
Mexico	Investment committees, whose members are appointed in special stockholders meetings to guarantee independence of the CIS, should be designated.	No		Yes	Yes
Netherlands	An administrative organisation to fulfil adequate segregation of functions may be put in place.	No		No, but any connected party transactions should be disclosed.	Yes, in the prospectus
New Zealand					
Norway					
Poland					
Portugal	Specific internal control measures must be implemented at a group level in order to ensure proper separation between particular sensitive areas.	Yes		Yes	No
Singapore	Internal control measures should be implemented to avoid conflict of interests. Each CIS operator is required to have a compliance unit.	Yes	Yes	Yes	Yes, in the prospectus and semi-annual report
Slovakia					
Spain	A compliance officer, who has the power and duty to limit the CIS operator's activity should be appointed.	Yes		Yes	Yes, in the prospectus and quarterly report
Sweden	Systems of internal controls and internal auditing must be implemented.	No		No	No
Switzerland	CIS operators are subject at group level to strict guidelines and internal rules.	Yes		Yes	No

Turkey	Organisational structure and internal control mechanisms are required.	No	No	Yes	Yes, in the prospectus, annual and semi-annual report
United Kingdom	A compliance officer should be appointed and compliance procedures should be set out.	Yes		Yes	Yes
United States	At least 40% of the directors on the board of a CIS should be independent.	No		Yes	Yes

3. EXERCISE OF SHAREHOLDER RIGHTS

	Are CIS allowed to have significant participation in the companies they invest? (7)	**Who is authorised to exercise the CIS rights as a shareholder of companies in which they invest? (8)**	**Can CIS's shareholder rights be delegated? (9)**
Australia		Responsible Entity	Yes
Austria			
Belgium	No. CIS may not acquire any shares carrying voting rights.	Management company	No
Canada	No. CIS may not invest for the purpose of exercising control or management.	Investment manager	Yes
Czech Republic	No.	Board of directors of CIS	Yes
Denmark	No	Board of directors of CIS or Management company	
Finland			
France	No	Management company	Yes
Germany	No	Management company	Yes
Greece	No	Management company	-
Hong Kong, China	No	Custodian or Trustee	Yes
Hungary			
Iceland			
Ireland	No	Board of directors of investment company or Management company	No
Italy	No	Management company	No

Japan	No	Trustee	Yes
Korea	No	Management company	No
Luxembourg	No	Board of directors of Investment company or Management company	Yes
Mexico	No. Law forbids CIS to become holding companies or to be in a position to control the management of companies.	Management company	No
Netherlands	Yes, as long as this is in conformity with their published investment policy.	Management company	Yes
New Zealand			
Norway			
Poland			
Portugal	No	Management company	Yes
Singapore	No	Trustee	Yes
Slovakia			
Spain	No	Management company	No
Sweden	No	Management company	Yes
Switzerland	No	Management company	Yes
Turkey	No, CIS may not invest for the purpose of exercising control and management.	Board of directors of CIS	No
United Kingdom	No	Trustee or Depository	Yes
United States	Yes, although some provisions of the law limit these participations.	Board of directors of Investment company	Yes

4. INTERNAL CONTROL

	Are there regulatory requirements or industry best practice standards regarding internal control, risk management systems or compliance function? (12)
Australia	Yes. CIS must have a compliance plan implemented by the operator.
Austria	
Belgium	Yes. Internal control is required by law.
Canada	No
Czech Republic	Yes. Internal control, risk management systems, and compliance function are required by law or authority.
Denmark	-
Finland	
France	Yes. Means and procedures to ensure effective internal controls should be put in place.
Germany	No
Greece	Yes
Hong Kong, China	Yes. There is a set of internal control guidelines.
Hungary	
Iceland	
Ireland	Yes. Internal control and compliance function are required by authority.
Italy	Yes. Internal control, risk management systems, and compliance function are required by law.
Japan	Yes
Korea	Yes. Internal control and compliance function are required by law.
Luxembourg	No
Mexico	No
Netherlands	Yes, there are industry best practice standards.
New Zealand	
Norway	
Poland	
Portugal	No, but CIS operators must have a compliance function.
Singapore	Yes, Internal control, risk management systems, and compliance function are required by authority or industry best practice standards.
Slovakia	
Spain	Yes

Sweden	No
Switzerland	Yes, there are industry best practice standards.
Turkey	No
United Kingdom	Yes, there are regulatory requirements
United States	Yes. Internal control, compliance function, and risk management systems are dealt as industry best practice standards.

ANNEX IV – ORIGINAL IOSCO QUESTIONNAIRE

I GENERAL FRAMEWORK

1. Typical legal structure of CIS in your jurisdiction. Describe, briefly, the role of different entities with responsibility for the conduct of the CIS (Operator, Custodian (including trustee or depository), Investment Manager).

2. Delegation of functions.

a) Are CIS operators allowed to delegate any or all of their functions?

b) If delegation is possible what are the responsibilities of the CIS operator with regard to:

   i) accountability to investors with regard to delegated functions; and
   ii) disclosure requirements;

c) Can there be sub-delegations? If so, what are the requirements that apply to such sub-delegations?

d) Are persons to whom functions are delegated:

   i) required to be registered with / approved by the regulator?
   ii) subject to supervision by the regulator?
   iii) subject to any other regulatory requirements?

II INFRASTRUCTURE FOR DECISION MAKING

Independent decision making

3. Are there any legal restrictions as to the relationship of CIS Operator with other group companies or prohibitions to carrying out activities with them, in order to ensure an independent decision making process?

4. Describe briefly the operational structure designed to ensure the integrity of the CIS and, in particular, whether it is required to implement *Chinese walls* or other specific internal control measures in order to avoid conflicts of interests within the organisation.

Codes of conduct

5. Does there exist in your jurisdiction a statutory Code of conduct enforceable for all CIS Operators as regards the full activity of Operators (ie: relationships with investors or any other group company, conflict of interests between shareholders, clients, directors, etc?).

6. If yes, is it applicable to the whole group when CIS operators are subsidiaries of a financial group?.

Representation of the interest of the CIS

7. Are CIS allowed to have significant participations in the companies they invest?

8. Who is entitled to hold and exercise the CIS rights as a shareholder of companies in which they invest?

9. Can the representation of CIS's shareholder rights be delegated to another entity? If yes, under what conditions.

10. Are there any restrictions, prohibitions or industry best practice standards regarding the exercise of CIS's shareholder rights in order to avoid conflicts of interests in the case of investments in:

- the controlling entity of the CIS Manager?
- other CIS group companies? and
- companies where other group companies have their own interests?

11. Is it required that the criteria followed for the exercise of CIS's shareholder rights are disclosed in the offer documents or other documentation of a CIS?

Internal control

12. Are there in your jurisdiction regulatory requirements relating to internal control and/or risk management systems or are these issues mainly dealt with as industry best practice standards?

13. Who is accountable for the implementation, development and on-going effectiveness of internal control of a CIS Operator?. Who is responsible for assessing the quantity and quality of means, resources and systems to be employed?.

14. Is it required that CIS Operators elaborate written policies and procedures? Who is responsible for its elaboration, reviewing and updating?

15. Describe the main issues to be covered by written policies and procedures

Risk management structures

16. Are there in your jurisdiction any rules or guidelines regarding the establishment of additional limits to those imposed by general regulation on portfolio investments as regards market risk, counterparty risk, liquidity risk, operational risk and legal risk of CIS?. If yes, how are these limits informed to investors?

17. Does the regulatory authority assess the models to be used by CIS Operator before they are implemented? Is any model acceptable to the regulatory authority or are there guidelines regarding the use of specific risk assessment models ?

III DISCLOSURE

18. In your jurisdiction, is disclosure to investors used to:

    a) inform investors of risks involved ?
    b) to deal with conflicts of interest ?

IV ENFORCEMENT

Compliance function.

19. Are there in your jurisdiction regulatory requirements regarding the implementation of a compliance function within the CIS Operators organisation or is this issue dealt with as industry best practice standards?

20. When the CIS Operator belongs to a financial group, could it be acceptable to have a unique compliance officer or department for the whole group?

21. If yes, there should be any rules of conduct to avoid conflict of interest?

22. Describe the main functions and areas to be covered by the compliance officer or department.

External Supervision

23. Does the regulatory authority undertake supervisory responsibility on the compliance of internal controls, risk management systems and conduct of business rules by CIS Operators?

24. What are the role of auditors, trustees, depositories or other parties in

- the assessment of the implementation and effectiveness of risk controls in the CIS Operator structure

- supervising internal control and risk management systems of CIS Operators

ANNEX V – BIBLIOGRAPHY

AGNEW, RUSSELL, Reforming Collective Investments, *The Australian Accountant*, 63 ,1993

ALEXEEVA, EKATERINA, et al., *Managing Collective Investment Funds*, Cadogan Financial

ANTHON, PHILIP, The Regulation of Collective Investments: The Role and Responsibilities of a Trustee, *Journal of Banking and Finance Law and Practice,* Volume 8, September 1997

AMERICAN BAR ASSOCIATION, *Fund Director's Guidebook,* Chicago, 1996

ASSOCIATION BELGE DES ORGANISMES DE PLACEMENT COLLECTIF, *Investir en Organismes de Placement Collectif(OPC): SICAV, SICAF et Fonds de Placement,* Brussels, September 1997

ASSOCIATION BELGE DES ORGANISMES DE PLACEMENT COLLECTIF, *Rapport sur l'exercice 1999,* Brussels, 1999

ASSOCIATION FOR INVESTMENT MANAGEMENT AND RESEARCH, *Global Investment Performance Standards,* April 1999

ASSOCIATION FRANÇAISE DE LA GESTION FINANCIÈRE, *Mandated Individualised Portfolio Management Professional Ethics,* April 1997

ASSOCIATION FRANÇAISE DE LA GESTION FINANCIÈRE, *Recommendations on Corporate Governance,* June 1998

ASSOCIATION FRANÇAISE DE LA GESTION FINANCIÈRE, *UCITS Professional Ethics,* June 1999

AUSTRALIAN LAW REFORM COMMISSION, *Collective Investments: Other People's Money, Report of the Companies and Securities Advisory Committee,* 1993

BANCO DE ESPANA, *Unit Trust Performance in 1991-1993 and Outlook,* July 1994

BUSINESS WEEK, *Mutual Funds: What's Wrong,* 24 January 2000

COMMISSION OF THE EUROPEAN COMMUNITIES, *Council Directive on the Coordination of Laws, Regulations and Administrative Provisions relating to Undertakings for Collective Investment in Transferable Securities*, Brussels, December 1985

DELWAIDE, HENRI, The Legal Framework of Investment Funds and Companies in Belgium, *Journal of International Banking Law,* Volume 11, No. 8, August 1996

DREW, GREGORY M., Collective Investments, *Journal of Applied Finance and Investment,* Volume 1, March/April 1996

EDELEN, ROGER M., Investor Flow and the Assessed performance of Open-end Mutual Funds, *Journal of Financial Economics,* 53, 1999

ERLICHMAN, STEPHEN I., *Making It Mutual: Aligning the Interests of Investors and Managers Recommendations for a Mutual Fund Governance Regime for Canada,* Prepared for the Canadian Securities Administrations, June 2000

FANT, L. FRANKLIN, O'NEAL, EDWARD S., Do You Need More than One Manager for a Given Equity Style?, *The Journal of Portfolio Management*, Summer 1999

FASKEN MARTINEAU DUMOULIN LLP, *Doing Business in Canada*, March 2000

FINANCIAL RESEARCH CORPORATION, *Exchange Traded Funds – An Emerging Alternative to Mutual Funds*, 2000
FORTHOMME, DENIS, Un Cadre Réglementaire Efficace pour les Fonds de Placement, *Revue de la Banque Bruxelles Lambert*, June 1990

GOMPERS, PAUL A., METRICK, ANDREW, *How are Large Institutions Different from Other Investors? Why do these Differences Matter*?, March 1998

HANRAHAN, PAMELA F., *Regulation of Managed Investment Schemes in Australia*, Centre for Corporate Law and Securities Regulation, The University of Melbourne, July 2000

HORST, JENKE R. TER, et al., *Style Analysis and Performance Evaluation of Dutch Mutual Funds*, May 1998

INVESTMENT COMPANY INSTITUTE, *Comments on the Reform of Regulation of Investment Companies*, October 1990

INVESTMENT COMPANY INSTITUTE, *Enhancing a Culture of Independence and Effectiveness, Report of the Advisory Group on Best Practices for Fund Directors*, June 1999

INVESTMENT COMPANY INSTITUTE, *Introductory Guide for Investment Company Directors*, September 1995

INVESTMENT COMPANY INSTITUTE, *Investments in Derivatives by Registered Investment Companies*, August 1994

INVESTMENT COMPANY INSTITUTE, *Mutual Fund Fact Book*, 40th edition, 2000

INVESTMENT COMPANY INSTITUTE, *Valuation and Liquidity issues for Mutual Funds*, February 1997

INVESTMENT COMPANY INSTITUTE, *401(k) Plans Participants: Characteristics, Contributions, and Account Activity*, Spring 2000

INVESTMENT TRUSTS ASSOCIATION JAPAN, *Investment Trusts in Japan*, Tokyo, April 2000

IOSCO, *CIS Unit Pricing, Report of the Emerging Markets Committee*, May 1999

IOSCO, *Collective Investment Schemes in Emerging Markets, Report of the Emerging Markets Committee*, September 1996

IOSCO, *A Comparison Between the Technical Committee Report and the Emerging Markets Committee Report on Valuation and Pricing of Collective Investment Schemes, Joint Report of the Technical Committee and the Emerging Markets Committee*, May 1999

IOSCO, *Conflicts of Interests of CIS Operators, Report by the Technical Committee*, May 2000

IOSCO, *A Directory of Information – Authorization of Collective Investment Schemes (CIS) and Related Services, Report of the Technical Committee*, October 1997

IOSCO, *Discussion Paper on International Cooperation in Relation to Cross-Border Activity of Collective Investment Schemes, Report of the Technical Committee*, June 1996

IOSCO, *Principles for the Supervision of Operators of Collective Investment Schemes, Report of the Technical Committee*, September 1997

IOSCO, *Regulatory Approaches to the Valuation and Pricing of Collective Investment Schemes, Report of the Technical Committee*, May 1999

IOSCO, *Report on Investment Management —Principles for the Regulation of Collective Investment Schemes and Explanatory Memorandum, Report of the Technical Committee*, October 1994

IOSCO, *Report on Investment Management, Report of the Technical Committee*, July 1995

IOSCO, *Summary of Responses to the Questionnaire on Principles and Best Practice Standards on Infrastructure for Decision Making for CIS Operators, Report by the Technical Committee*, May 2000

KIMURA, YOGO, *Japanese Investment Fund Regulation Updated*, IBA !0th Annual Conference "Globalisation of Mutual Funds", Bermuda, May 1999

LYNCH, ANTHONY W., MUSTO, DAVID K., *Understanding Fee Structures in the Asset Management Business*, December 1997

MAES, J.P., DE SCHRYVER, V., *Collective Investment Funds and Conflicts of Interest*, May 2000

OECD, *Standard Rules for the Operations of Institutions for Collective Investment in Securities, Report by the Committee on Financial markets*, Paris, February 1972

PAUL, THOMAS, Corporate Governance in the German Mutual Fund Industry, *International Business Lawyer*, June 2000

SECTOR ANALYSIS, *Waves across the Atlantic: Predicting futures trends in the fund industry in Europe*, 2000

SEKI, Yuta, Investment Trust Law Revisions to Expand Scope of Investments, *Capital Research Journal*, Vol. 3 No. 2, Nomura Research Institute

SINGAPORE BUSINESS, *In units we trusts?*, February 1996

SINGAPORE BUSINESS, *With a little help from the experts*, April 1998

STEVENS, PAUL SCHOTT, *Mutual Fund Governance Structure: A Comparative Analysis*, Paper prepared by Investment Company Institute for 11th Annual International Investment Funds Conference, October 1997

STROMBERG, GLORIANNE, *Investment Funds in Canada and Consumer Protection: Strategies for the Millennium*, Ontario Securities Commission, October 1998

STROMBERG, GLORIANNE, *Regulatory Strategies for the Mid-'90s: Recommendations for Regulating Investment Funds in Canada*, Ontario Securities Commission, January 1995

TRZCINKA, CHARLES A., *Mutual Fund Fees and Competition in the Mutual Fund Industry*, Testimony before the House Committee on Commerce, Subcommittee on Finance, September 1998

TSCHÄNI, HANS, VON BALLMOOS, THOMAS, *The Swiss Experience*, Paper presented at the FEFSI workshop on corporate governance issues, June 2000

RELATED WEBSITES

Association Française de la Gestion Financière: www.afg-asffi.com

Association Luxembourgeoise des Fonds d'Investissement: www.alfi.lu

Association of Unit Trusts and Investment Funds(United Kingdom): www.investmentfunds.org.uk

Associação Portuguesa das Sociedades Gestoras de Patrimoniose de Fundos de Investimento: www.apfin.pt

Assogestioni(Italy): www.assogestioni.it

Australian Securities & Investments Commission: www.asic.gov.au

Bundesverband Deutscher Investment-Gesellschaften e. V.: www.bvi.de

Commissione Nazionale per le Societa'e la Borsa(Italy): www.consob.it

Dublin Funds Industry Association: www.dfia.ie

Federation of Danish Investment Association: www.ifr.dk

Finnish Association of Mutual Funds: www.sijoitusrahastot.fi

Hong Kong Investment Funds Association: www.hkifa.org.hk

International Organization of Securities Commissions: www.iosco.org

Inverco(Spain): www.inverco.es

Investment Company Institute: www.ici.org

Investment Funds Institute of Canada: www.ific.ca

Investment Savings and Insurance Association(New Zealand): www.isi.org.nz

Korea Investment Trust Companies Association: www.kitca.or.kr

Management Practice, Inc.: www.mfgovern.com

Mutual Fund Cafe: www.mfcafe.com

Ontario Securities Commission: www.osc.gov.on.ca

Robeco Group(Netherlands): www.robeco.com

Swedish Mutual Funds Association: www.fondbolagen.se

Union of Greek Institutional Investors: www.ugii.gr