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TAKING ANOTHER LOOK AT THE REGULATION OF MUTUAL FUNDS IN THE AFTERMATH OF THE ASIAN FINANCIAL CRISIS

Thomas Krider

Abstract: This Comment analyzes the 1997 financial crisis in Asia and its effect on U.S. mutual fund investors. The crisis was most acute in, and this Comment focuses on, the countries of Thailand, Indonesia and South Korea. The lack of transparency in these countries led to substantial losses for U.S. investors whose money was in non-transparent organizations through their ownership of mutual funds. The International Monetary Fund responded to the Asian crisis with aid packages intended to prevent the insolvency of those countries in financial trouble. As part of the IMF's program, one of the primary requirements for receiving aid is for each country to improve the level of financial transparency required of its business and financial sectors. U.S. mutual fund investors could be better protected against unnecessary losses, and the success of the IMF program greatly enhanced, by either increasing the level of disclosure required of the underlying securities held in a mutual fund's portfolio, or by prohibiting investment by mutual funds in companies who lack adequate financial transparency.

I. INTRODUCTION

After years of dramatic expansion,[1] many of Asia's economies experienced severe financial crisis in 1997.[2] In response, the International Monetary Fund ("IMF") has stepped in and offered individual countries financing packages intended to stabilize their economies and help relieve some of the hardship being experienced.[3] To receive this financial assistance, however, the IMF is requiring numerous fiscal and macroeconomic changes

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[1] "During the past 20 years, the high growth performers in east and southeast Asia have persistently grown at 6-8 percent per annum." Shigemitsu Sugisaki, Deputy Managing Director of the International Monetary Fund, Address at the 1998 Harvard Asia Business Conference, (Jan. 30, 1998), *available in International Monetary Fund Homepage* (visited March 3, 1998) <http://www.imf.org/external/np/speeches/1998/013098.HTM>.

[2] The crisis has been described as "[a devaluation of national currencies in Asia which] triggered a region-wide crisis, in which stock markets gave up as much as 35 percent of their value, inflated real estate prices fell through the floor, banks collapsed, and hundreds of thousands of Southeast Asians, rich and poor, lost their jobs and fortunes." Michael S. Serrill, *Catching the Asian Flu; The Sickness That Put the Tigers in the Tank Causes a Big Sneeze in the U.S. Market*, TIME, Nov. 3, 1997, at 44.

[3] It is estimated that the cost of the IMF bailout package for Asia will be between $118 billion and $163 billion. Thailand has already received $22 billion, Indonesia is estimated to require $40 billion, and Korea has asked for $55 billion and may need as much as $75-100 billion. Bryan T. Johnson & John Sweeney, *Down the Drain: Why the IMF Bailout in Asia is Wasteful and Won't Work*, HERITAGE FOUNDATION REPORTS, Dec. 5, 1997.

within the recipient countries.[4] Included among these changes is a requirement to create transparency in the financial reporting of domestic corporations by implementing accounting practices consistent with internationally accepted accounting principles.[5]

The lack of financial transparency in both the government and private sectors of these countries has had a direct effect on investors within the United States.[6] Americans who were most immediately and directly harmed by the Asian crisis are those investors who relied on mutual funds as their vehicle into the Asian equity markets.[7] Mutual fund securities purchased by investors in the United States are subject to regulation by the Securities and Exchange Commission.[8] These funds fall under the Investment Company Act of 1940 which requires significant disclosure and regulation of mutual fund management.[9] Yet these regulations, unlike those in other areas of investing, do not require disclosure of the financial positions of the individual stocks held within a mutual fund's portfolio.[10] This lack of disclosure leaves investors in overseas mutual funds without many of the safeguards normally found when investing in individual corporate securities within the United States.[11]

Through legislation, the United States could help to ensure the success of the financial transparency requirements of the IMF bailout package, and at the same time, improve investor safeguards within the United States. This legislation could be targeted at either the types of disclosure required regarding the financial position of stocks held in a mutual fund's portfolio, or

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[4] In the case of Thailand, the Thai government has signed a "Letter of Intent" dated February 24, 1998, addressed to Michel Chamdessus, Managing Director of the IMF, in which it outlines the measures it has committed to implementing in conjunction with the IMF financial package. Government of Thailand, Letter of Intent, *available in International Monetary Fund Homepage* (visited Mar. 24, 1998) <http://www.imf.org/external/np/loi/022498.htm> [hereinafter *Letter of Intent*]. The term Letter of Intent is used by the IMF to describe the document(s) issued by a recipient government to the IMF delineating the country's program for economic reforms. Thailand's "Letter of Intent" is also referred to as "Memorandum of Economic Policies of the Royal Thai Government."

[5] *Id.*

[6] Many key pieces of financial information are frequently withheld by corporations, contributing to the collapse of the region's stock markets and the devaluing of many of its currencies. Shanthi Kalathil, *Asia Gets a Hard Lesson in Costs of Firms' Murky Bookkeeping*, WALL ST. J., Dec. 15, 1997, at A19.

[7] Some examples of mutual fund performances are Merrill Lynch's Developing Capital Fund (high-$17.91 low-$11.04 loss-38%), Pacific Basin Fund (high-$26.84 low-$16.49 loss-38%), Putnam's Asian Pacific Growth Fund (high-$14.86 low-$10.26 loss-31%), and Nomura's Pacific Basin Fund (high-$15.47 low-$9.40 loss-39%). Data Broadcasting Center, *DBC Online* (visited Mar. 28, 1998) <http://www.dbc.com>.

[8] The Investment Company Act of 1940, 15 U.S.C. § 80a (1997).

[9] *Id.*

[10] *Id.*

[11] *Id.*

at requiring the equities held within a fund's portfolio to meet the minimum transparency requirements proposed by the IMF.

This Comment will begin by looking at some of the underlying problems which led to the collapse of several Asian economies at the end of 1997. In particular, it will focus on Thailand, Indonesia, and South Korea. It will then discuss the IMF's program for stability and long term solutions, focusing primarily on the requirement for increased financial transparency through implementation of internationally accepted accounting principles. Next, it will look at the law governing mutual fund disclosure in the United States. It will look at how mutual funds are allowed to own securities in corporations which are not themselves subject to strict oversight and regulation. It will show that U.S. investors in overseas mutual funds lack sufficient information to make rational investment decisions. This Comment will recommend that the United States amend its statutory and regulatory structure to require mutual fund managers to improve disclosure regarding the transparency of the equities they hold, or to allow investment only in corporations which adhere to internationally accepted accounting principles. Finally, it will argue that the latter of these two alternatives is the best way to ensure the success of the IMF program.

II. THE TIGERS' WOES

A. The Thorn

The miraculous Asian Tigers,[12] whose economies raced and roared impressively over the course of many years, have collapsed to the ground, whimpering with a festering infection in their paws, caused by a thorn the Tigers knew existed but chose to ignore.[13] The Asian economic expansion had been lauded throughout the 1990's as the blueprint for the economic

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[12] Investment companies established specific mutual funds targeted at capturing the region's economic expansion. The "Tigers" which most of these funds targeted were the countries of Hong Kong, Singapore, Malaysia, China, the Philippines, Taiwan, South Korea, Thailand and Indonesia. *Colonial Launches Innovative Ad Campaign*, PR Newswire, Dec. 3, 1996, *available in* LEXIS, News Library, Curnws File.

[13] *See* Stanley Fischer, First Deputy Managing Director of the IMF, *The IMF and the Asian Crisis*, Address at Forum Funds Lecture at the University of California, Los Angeles (Mar. 20, 1998), *available in International Monetary Fund Homepage* (visited Mar. 23, 1998) <http://www.imf.org/external/np/speeches/1998/032098.HTM> [hereinafter Fischer Address].

salvation of developing nations.[14] Yet several of the Tigers have stumbled due to their inability, or unwillingness, to see the warning signs that existed on the horizon.[15] Some of the warning signs included: (1) large external deficits along with property and stock market bubbles; (2) pegged exchange rates which required large amounts of foreign reserve to maintain; and (3) lax prudential rules and financial oversight of the banking industries.[16] The events which led to a crisis within each of the countries may have been unique to each particular country, but in the end, each has come, "hat in hand,"[17] seeking help from the international community via the IMF.[18]

The first of Asia's economic juggernauts to fall was Thailand.[19] After years of pegging its currency to the U.S. dollar,[20] the Thai government was no longer willing, or able, to purchase enough Thai baht to maintain its exchange value.[21] The Thai central bank finally removed the fixed exchange rate on July 2, 1997, and allowed the baht to float against the dollar.[22] Once the currency was allowed to float, it immediately lost seventeen percent of its value against the U.S. dollar and twelve percent of its value against the yen.[23] The Thai stock market followed the baht's devaluation with a collapse of its own. In early January 1997, the Thai Stock Exchange closed at 828 points.[24] A year later the index was all the way down to 495 points,[25] a drop of over forty percent.[26]

Prior to July 2, 1997, the Thai government had used a substantial portion of its foreign reserves to buy baht in an attempt to maintain its

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[14] A study published in *Oil and Industry News* encourages Arab countries to follow the model provided by East Asia. *Arabs Urged to Copy Asian Economic "Miracle,"* Agence Fr. Presse, Feb. 14, 1996, *available in* LEXIS, News Library, Arcnws File.

[15] Fischer Address, *supra* note 13.

[16] *Id.*

[17] Leo Abruzzese, *Japan Key to Asian Crisis*, J. COM., Dec. 5, 1997, at 7A.

[18] *Id.*

[19] While South Korea and Indonesia did not request assistance until late in 1997, Thailand first requested IMF help in July 1997. David Holley, *Thailand Seeks Economic Aid Package From IMF; Asia: The Action is Triggered By International Pressure on Bangkok to Come to Terms With the Devaluation of Its Currency*, L.A. TIMES, July 29, 1997, at D1.

[20] Thailand's central bank had made currency stability its top priority for the last thirteen years. *Exchange Rates. Thaied up in Knots*, ECONOMIST, July 5, 1997, at 71.

[21] The central bank spent $15 billion buying baht in an attempt to prop-up the currency at an exchange rate of 25 baht to the dollar. Tony Emerson, *After the Rescue*, NEWSWEEK, Aug. 25, 1997, at 37.

[22] *Id.*

[23] *Exchange Rates*, *supra* note 20.

[24] *Thai Stocks Rebound*, UPI, Jan. 15, 1997, *available in* LEXIS, News Library, Curnws File.

[25] *International Economy: Asia*, BARCLAYS BANK ECON. REV., Feb. 19, 1998, at 27.

[26] (828-495)/828=.4028

exchange value against the dollar.[27] Once the devaluation of the currency occurred, Thailand was left without sufficient resources to pay its bills.[28] This deficiency forced the government to seek financial protection against its creditors through loans from the international community.[29]

Indonesia's crisis primarily centered around the collapse of its financial sector.[30] Following the deregulation of Indonesia's banking industry several years ago, the number of banks in Indonesia mushroomed to a total of two-hundred and forty by the time of the crisis in 1997.[31] The increase in the number of banks became a problem because, as the number of banks increased, the government failed to increase its monitoring over the banking industry.[32] The lack of regulatory oversight allowed Indonesian banks to make a significant number of bad loans.[33] The fear of a run on bank deposits led the government to close or suspend the operation of seven banks[34] and to take over the management of forty-seven others.[35] Indonesia also saw its currency plummet as a result of the country's economic troubles.[36] The rupiah lost eighty-five percent of its value against the dollar between early 1997 and January of 1998.[37] This made servicing their international debt obligations nearly impossible.[38] The collapse of the rupiah had caused

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[27] Thailand had $20 billion remaining in foreign currency reserves, but was only months away from debts coming due worth in excess of $50 billion. Emerson, *supra* note 21, at 37.

[28] *Id.*

[29] The initial package was for $16 billion with contributions coming from the IMF ($4 billion), Japan ($4 billion), Australia ($1 billion), Hong Kong ($1 billion), Malaysia ($1 billion), Singapore ($1 billion), Indonesia ($500 million), South Korea ($500 million), and the Asian Development Bank ($3 billion). Hiroshi Yamagiwa, *Thai Bailout Plan to Cost $16 Billion*, JAPAN TIMES WKLY. INT'L ED., Aug. 18, 1997, at 1, 6.

[30] On November 1, 1997, the government of Indonesia closed sixteen banks stating that they were unhealthy and insolvent. *Closed Indonesian Banks Begin Refunding Depositors*, Agence Fr. Presse, Nov. 13, 1997, *available in* LEXIS, News Library, Curnws File.

[31] *How Far is Down?*, ECONOMIST, Nov. 15, 1997, at 19.

[32] *Id.*

[33] Indonesia has attempted to implement a plan to guarantee the obligations of the country's banks and establish a group to dispose of troubled banks and their "massive bad loans." Paul Blustein, *Indonesia Announces Bank Guarantee Plan; Troubled Nation Moves to Avert Collapse of System, Reassure Foreign Investors*, WASH. POST, Jan. 27, 1998, at D3.

[34] One newswire reported shortly after the events that "[t]he Indonesian government froze Saturday the operation of seven commercial banks—three of them linked to the first family—and a government-appointed agency took over management of seven others, including a state bank, effective that day." Christine T. Tjandraningsih, *Indonesia Closes 7 Banks, Takes Over 7 Others*, Japan Econ. Newswire, Apr. 4, 1998, *available in* LEXIS, News Library, Curnws File.

[35] Indonesia's agency responsible for restructuring the banking sector now oversees a total of 54 banks. *Indonesia's Banks, No Credit*, THE ECONOMIST, Apr. 11, 1998, at 57.

[36] Paul Handley, *Can Indonesia Survive Suharto?*, INSTITUTIONAL INVESTOR, Feb. 1998, at 72.

[37] *Id.*

[38] *Id.*

speculation that a large number of Indonesian corporations were also in serious trouble.[39] This concern was reflected in the change of the value of the Stock Exchange index, which lost thirty-three percent of its value between June 1997 and January 1998.[40]

South Korea has suffered many of the same problems as Thailand and Indonesia.[41] South Korea drained its foreign currency reserve through months of attempting to uphold the value of the won.[42] The lack of reserves led to a serious international debt crisis in the fall of 1997.[43] The debt crisis, combined with dramatic falls in the value of both the won and the South Korean stock market,[44] made international investors extremely nervous about South Korea.[45] Unlike Thailand, whose crisis was triggered by an exchange rate collapse,[46] or Indonesia, where failed banks led the way,[47] South Korea's trouble began with several bankruptcies involving some of its large private corporate conglomerates.[48] These primarily family-owned conglomerates, known as chaebols,[49] control much of the wealth in Korea.[50] They have traditionally shunned equity financing,[51] instead using enormous debt, based upon political rather than financial collateral, to run their enterprises.[52] The

[39] "Mohammad Syahrial of Pentasena Securities said that only 22 of the 280-odd companies on the Jakarta Stock Exchange appeared financially viable." *Id.*

[40] *International Economy: Asia*, *supra* note 25, at 27.

[41] The IMF's Stanley Fischer stated in a speech that "Thailand, Indonesia and Korea face a number of similar problems, including the loss of market confidence, deep currency depreciation, weak financial systems, and excessive unhedged foreign borrowing by the domestic private sector." Fischer Address, *supra* note 13.

[42] Velisarios Kattoulas, *Korea Hovers on Brink As Stocks Plummet 7%; IMF Bailout May Be Needed This Month, Economists Say, as Won Hits a Record Low*, INT'L HERALD TRIB., Nov. 8, 1997, at 13.

[43] South Korea had foreign debts totaling $110 billion, but a currency reserve dropping below a level of $30 billion. *Troubled, but Basically Sound*, BUS. KOREA, Dec., 1997, at 29-31.

[44] During the turbulent period in the fall of 1997, both the won and the stock market lost half their value. Sandra Sugawara, *In S. Korea, Business Anything but Usual; A Surprisingly Aggressive Kim Stuns Foreign, Korean Investors Alike*, WASH. POST, Feb. 24, 1998, at A15.

[45] South Korea is the world's eleventh-largest economy. *Id.*

[46] *Exchange Rates*, *supra* note 20.

[47] *Closed Indonesian Banks*, *supra* note 30.

[48] Kattoulas, *supra* note 42.

[49] Chaebols are largely credited with Korea's enormous economic growth. Joongi Kim, *Cultural Differences in the Crusade Against International Bribery: Rice-Cake Expenses in Korea and the Foreign Corrupt Practices Act*, 6 PAC. RIM L. & POL'Y J. 549, 567 n.95 (1997).

[50] Sugawara, *supra* note 44.

[51] The selling of shares in the chaebol to raise capital would lead to the dilution of family control, which is something the controlling families have been unwilling to do. *Id.*

[52] *Id.*

chaebols are the main focus of the IMF's restructuring program in Korea,[53] and despite their traditional resistance to change, they are showing a willingness to agree to reform their business practices.[54]

B. The Help

The IMF arranged a significant amount of foreign monetary assistance in the form of loans in an effort to maintain the solvency of Asia's troubled nations.[55] As a condition of the IMF's assistance, the recipients of the loans had to agree to various programs of internal restructuring.[56] These programs differ from previous IMF bailout programs[57] in that they focus less on macroeconomic policy and more on reforming the financial and corporate sectors in each country.[58] One of the primary methods of accomplishing those reforms is a requirement for those sectors to increase their financial transparency by implementing internationally accepted accounting practices and disclosure rules.[59]

Prior to the crisis in Asia, the IMF's largest bailout program was the one involving Mexico in 1994, which totaled forty-eight billion dollars.[60] By comparison, the total package in Asia is expected to be in the neighborhood

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[53] Don Kirk, *Pressure on Chaebol: Change Now or Break Up*, INT'L HERALD TRIB., Dec. 4, 1997, at 1.

[54] *Asia Learns the 3 Rs -Repent, Repay, Rebuild*, THE STRAITS TIMES, Mar. 25, 1998, at 26.

[55] It is estimated that the total amount of assistance channeled through the IMF will be somewhere in the neighborhood of $118 billion dollars, with some fearing it could reach as high as $163 billion. Johnson and Sweeney, *supra* note 3.

[56] Fischer Address, *supra* note 13.

[57] *See* Michel Camdessus, Managing Director of the IMF, Address Before the Counsel on Foreign Relations, New York, (Feb. 6, 1998), *available in International Monetary Fund Homepage* (visited Mar. 23, 1998) <http://www.imf.org/external/np/speeches/1998/020698.HTM>.

[58] Stanley Fischer stated in a speech that:

> Macroeconomic adjustment is not the main element in the programs of Thailand, Indonesia, and Korea. Rather[,] financial sector restructuring and other structural reforms lie at the heart of each program—because the problems they deal with, weak financial institutions, inadequate bank regulation and supervision, and the complicated and non-transparent relations among governments, banks, and corporations, lie at the heart of the economic crisis in each country.

Fischer Address, *supra* note 13.

[59] *See* Michel Camdessus, Managing Director of the IMF, Address Before the Extraordinary Ministerial Meeting of the Group of 24, Caracas, Venezuela, (Feb. 7, 1998), *available in International Monetary Fund Homepage* (visited Mar. 23, 1998), <http://www.imf.org/external/np/speeches/1998/020798.HTM>.

[60] Richard Lacayo, *IMF to the Rescue; As East Asia Sinks Further into Economic Quicksand, the International Monitary Fund is Swooping in with Money and Advice. But is the IMF, Whose Biggest Donor is the U.S., the Perfect Action Hero, or Will its Help Only Make Matters Worse?*, TIME, Dec. 8, 1997, at 36.

of around one-hundred and eighteen billion dollars divided among several countries.[61] The money the IMF uses for its piece of the overall financing plan[62] comes from deposits made into the IMF from member countries, the largest depositor being the United States.[63] The extent of the current crisis in Asia has necessitated a request by the IMF to member states to increase the amount of money deposited into the fund.[64] This request has been met with resistance within the United States Congress.[65] Although the IMF is in no danger of actually running out of money, increased deposits are necessary to insure continued availability of funds in the future.[66]

In exchange for the loans offered through the IMF, Thailand has agreed to institute a series of extremely serious and far-reaching measures intended to facilitate repayment of the loans.[67] The first major step the Thai government has agreed to take is in the restructuring of the banking industry.[68] It intends to implement programs instituting "best banking practices"[69] and improve the legal, regulatory, and institutional framework for the central bank.[70] In addition to changing banking laws, the Thai government has committed to adjusting its fiscal policy to account for the lower levels of revenue and increased demand for social spending.[71] It has agreed to maintain a strict monetary position in order to stabilize exchange rates.[72] It has also agreed to strengthen its social safety net to deal with rising

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[61] Johnson and Sweeney, *supra* note 3.

[62] The IMF does not provide the entire financing for the bailout programs. Instead, it coordinates the rescue package among the various contributing organizations in addition to the amount the IMF makes available from its own coffers. For example, early in the Indonesian crisis, the IMF bailout consisted of contributions from IMF ($10 billion), World Bank ($4.5 billion), Asian Development Bank ($3.5 billion), and an additional $18 billion from various other countries. Eric Altbach, *Japan, United States Back Up IMF Indonesian Bailout Plan*, JEI REPORT, Nov. 7, 1997, *available in* LEXIS, News Library, Curnws File. The Korean bailout would be funded by the United States and Japan (giving $20 billion), World Bank ($15 billion), and the rest from the IMF. Andrew Pollack, *South Korea Says I.M.F. has Agreed to Huge Bailout*, N.Y. TIMES, Dec. 1, 1997, at A1.

[63] The IMF currently has around $200 billion dollars in its coffers, with $36 billion (18% of the total) coming from the United States. Lacayo, *supra* note 60.

[64] President Clinton has asked Congress to approve an additional $18 billion worth of funds for use by the IMF in meeting the demands of the crisis. Although this does not count as an expenditure against the U.S. budget, it has met with sharp resistance by some members of Capitol Hill who feel this is simply an effort to "bail out bankers." *The Fight to Fund the Fund*, THE ECONOMIST, Feb. 21, 1998, at 25-26.

[65] *Id.*

[66] *Id.*

[67] *Letter of Intent*, *supra* note 4.

[68] *Id.*

[69] *Id.*

[70] *Id.*

[71] *Id.*

[72] *Id.*

unemployment and falling real wages.[73] The Thai government has adopted bold targets for increasing the role of the private sector in the country's economy, and intends to increase the amount of privatization and legal reforms.[74]

One of the government's programs for improving financial transparency was begun before the current economic crisis. In 1992, the Thai government established a Securities and Exchange Commission whose primary purpose is to provide the administration necessary both to develop and supervise the Thai capital markets.[75] As part of that program, the Securities and Exchange Commission has worked with the Institute of Certified Accountants and Auditors of Thailand (ICAAT) to develop new accounting standards for the country.[76] When the crisis occurred, the Thai government had not yet adopted new accounting standards, but it has agreed to strengthen both the disclosure and auditing requirements and accounting practices by the end of 1998.[77]

Indonesia has been much more resistant to implementing the reforms demanded by the IMF.[78] After renewing his county's commitment to implementing the reforms mandated by the IMF,[79] President Suharto later indicated that the economic reforms demanded by the IMF would violate the Indonesian Constitution's section on "social well-being."[80] Much of President Suharto's concern is likely based upon the impact the agreement would have on an already ravaged economy,[81] although there is also some indication that his concern may lay in protecting the vast fortunes amassed by his friends and family members through government-protected

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[73] *Id.*

[74] *Id.*

[75] *The Securities and Exchange Commission of Thailand and the Thai Capital Market*, ASIAMONEY, May 1997, *available in* LEXIS, News Library, Curnws File.

[76] *Id.*

[77] *Letter of Intent*, *supra* note 4, at Box 2.

[78] Although President Suharto signed Indonesia's first agreement with the IMF in October, he has yet to make good on many of the promises. Gregg Jones, *Suharto's Stand; Leader's Comments Sting IMF, Spark Uncertainty in Indonesia*, DALLAS MORNING NEWS, Mar. 10, 1998, at 1D. "To be sure, Jakarta did not help itself much by not showing serious commitment to its reforms." Susan Sim, *Flexibility the Buzzword*, STRAITS TIMES, Mar. 24, 1998, at 8.

[79] Michel Camdessus, *IMF and Indonesia Agree on Accelerated Economic Reforms*, 27 IMF SURVEY 17-19 (1998).

[80] Jones, *supra* note 78.

[81] "A number of analysts agree that Suharto can validly argue that imposing further austerity measures on a nation that is already reeling from soaring inflation and unemployment would be a mistake . . . ." *Id.*

monopolies.[82] The necessity of improving transparency and accounting standards is even more acute in Indonesia where they do not have general auditing and reporting requirements,[83] and the general accounting principles in the country are significantly divergent from international standards.[84] As of this writing, it is still unclear whether Indonesia will fully accept the program offered by the IMF or if it will shirk the help and possibly send itself, and perhaps the rest of the world, into an even deeper financial crisis.[85]

South Korea was well on its way to implementing much of the reform program by the time it submitted its "Letter of Intent" to the IMF.[86] The "Letter" describes in detail Korea's plans for implementing changes in the following areas: macroeconomic policy (e.g. monetary policy, exchange rate policy, reserve management, and fiscal policy); financial sector restructuring of both merchant and commercial banks as well as improving the legislative and regulatory structure for the industry; and capital account liberalization, trade liberalization, labor market reform and social safety net improvement as well as corporate governance and restructuring (focusing on transparency and accountability to shareholders).[87] South Korean President Kim Dae-jung has helped pave the way for implementation of the IMF program in key ways: first, by getting the nation's four largest conglomerates to agree to the transparency reforms outlined by the IMF,[88] and then by getting organized labor to

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[82] For a discussion of the role Suharto's six children and other business cohorts play in the economic life of Indonesia, *see* Handley, *supra* note 36.

[83] COOPERS & LYBRAND, INTERNATIONAL ACCOUNTING SUMMARIES: A GUIDE FOR INTERPRETATION AND COMPARISON I-28 (2nd ed. 1993).

[84] The Indonesian Accounting Principles differ from the IAS in how they account for joint ventures, foreign currency, government grants and assistance, research and development. *Id.* at I-44-45.

[85] On May 21, 1998, after weeks of political turmoil and deadly riots within Indonesia, President Suharto resigned. He was immediately replaced by his former Vice President, B.J. Habibie. The questions of how Habibie will deal with Indonesia's economic crisis, and whether his presidency will be accepted by the Indonesian people, may take some time to be answered. Keith B. Richburg, WASH. POST, May 21, 1998, at A1.

[86] South Korea has signed a Letter of Intent dated February 7, 1998 and addressed to Michel Chamdessus, Managing Director of the IMF, in which it outlines measures already undertaken and lists the measures it intends to implement in conjunction with the IMF financial package. Government of South Korea, Letter of Intent, *available in International Monetary Fund Homepage* (visited Mar. 26, 1998) <http://www.imf.org/external/np/loi/020798.htm>. *See supra* note 4 and accompanying text for a discussion of the term Letter of Intent.

[87] *Id.*

[88] *DJ to Stress Major Self-Reform by Big Groups*, KOREA HERALD, Feb. 5, 1998, *available in* LEXIS, News Library, Curnws File.

agree to legislation allowing crippled businesses to lay off workers who have previously been guaranteed lifetime employment.[89]

III. MUTUAL FUNDS IN THE UNITED STATES

A. *Financial Transparency in the United States*

When formulating solutions for Asia's lack of transparency, looking to the United States' example can provide useful insight. All mutual funds[90] in the United States are governed by The Investment Company Act of 1940 (hereinafter Act)[91] and the regulations promulgated pursuant to it.[92] The basic intent of the Act has been described as follows:

> The . . . Act . . . establishes a comprehensive federal regulatory framework for investment companies. Regulation of investment companies is designed to: prevent insiders from managing the companies to their benefit and to the detriment of public investors;[93] prevent the issuance of securities having inequitable or discriminatory provisions;[94] prevent the management of investment companies by irresponsible persons;[95] prevent the use of unsound or misleading methods of computing earnings and asset value;[96] prevent changes in the character of investment companies without the consent of investors;[97] ensure the disclosure of full and accurate information about the companies and their sponsors.[98] To accomplish these ends, the Investment

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[89] Don Kirk, *Korean Unions Reluctantly Agree to Layoffs*, INT'L HERALD TRIB., Feb. 7, 1998, at 1.
[90] The Supreme Court has defined a mutual fund as:

> A mutual fund is an open-end investment company. The . . . Act . . . defines an investment company as an 'issuer' of 'any security' which 'is or holds itself out as being engaged primarily *** in the business of investing *** in securities ***.' 15 U.S.C. §80a-2(a)(21), 80a-3(a)(1). An open-end company is one 'which is offering for sale or has outstanding any redeemable security of which it is the issuer.' 15 U.S.C. §80a-5(a)(1)

Investment Co. Institute v. Camp, 401 U.S. 617, 625 n.11 (1971).
[91] 15 U.S.C. § 80a (1997).
[92] 15 C.F.R. § 200.1-290.101 (1998).
[93] 15 U.S.C. § 80a-10 (1997).
[94] 15 U.S.C. § 80a-18 (1997).
[95] 15 U.S.C. § 80a-9 (1997).
[96] 15 U.S.C. § 80a-29 (1997).
[97] 15 U.S.C. § 80a-13 (1997).
[98] Referring to investment companies, 15 U.S.C. § 80a-29 (1997).

Company Act ... restricts greatly transactions with affiliates,[99] limits leveraging,[100] and imposes governance requirements as a check on fund management.[101]

The emphasis of the Act is to protect investors through a process of full and accurate disclosure.[102] Most of the Act's provisions deal with the formation and operation of the mutual fund.[103] Nowhere in the Act does it require mutual funds to purchase equity in any particular type of company, nor does it require that the companies owned within a mutual fund's portfolio meet minimum accounting and disclosure requirements themselves.[104] The Act does, however, regulate the percentage of a portfolio company that a mutual fund is allowed to own,[105] and how the fund's assets must be distributed, depending on the nature of the fund.[106] These requirements help to ensure that the structure and operation of a mutual fund is transparent to individuals seeking to invest in a particular fund.

The transparency of corporate securities traded within the United States is assured by the laws and regulations promulgated as part of the Securities and Exchange Acts of 1933 and 1934.[107] When Congress passed the 1933 Act, it focused primarily on requiring extensive disclosure for the distribution of newly issued public securities.[108] Examples of the disclosure requirements set forth in the 1933 Act are: (1) the registration of securities with the Securities and Exchange Commission (SEC) before they are offered for sale; and (2) the distribution of prospecti providing detailed information about the company to potential investors.[109]

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[99] 15 U.S.C. § 80a-56 (1997).

[100] 15 U.S.C. § 80a-12 (1997).

[101] This statement is taken from an Extension of Remarks submitted by Congressman John D. Dingell of Michigan into the congressional record as part of the debate over impending legislation. 142 CONG. REC. E1938-05, *available in* 1996 WL 602735. This statement is a fair reflection of the language found in the Investment Company Act of 1940's declaration and policy section. 15 U.S.C. § 80a (1997).

[102] *See supra* note 100.

[103] *Id.*

[104] 15 U.S.C. § 80a (1997).

[105] The Act requires that any diversified mutual fund may not own more than 10% of any company within its portfolio. 15 U.S.C. §80a-12(c) (1997); *See also* Mark J. Roe, *Political Elements in the Creation of a Mutual Fund Industry*, 139 U. PA. L. REV. 1469, 1472-6 (1991).

[106] SEC guidelines require at least 65% of a fund's assets to be invested in the fund's primary area of emphasis. *In re* Alliance North America, No. 95 Civ. 0330, 1996 WL 551732 (S.D.N.Y. Sept. 27, 1996) (citing 6 FED. SEC. L. REP. 51,208, 39252.).

[107] 15 U.S.C. § 78a (1994).

[108] *See* LOUIS LOSS, FUNDAMENTALS OF SECURITIES REGULATION 36 (1988).

[109] *Id.* at 87-92.

The 1934 Act deals with the trading of securities after they have been issued.[110] The 1934 Act protects investors in a number of ways: it requires a corporation to continue making regular disclosure of its financial position to the SEC;[111] a corporation is required to register the proxy statements it uses for gaining shareholder approvals;[112] when certain tender offers are made for the purchase of a publicly traded company, the contents of the offer must be filed with the SEC;[113] corporations are also prohibited in a number of ways from engaging in various forms of insider trading;[114] and investors are protected from false or fraudulent statements or omissions made by individuals in connection with the purchase or sale of securities.[115]

The SEC helps to ensure financial transparency within the registration and disclosure functions by requiring financial data to conform with the United States' generally accepted accounting principles (hereinafter GAAP).[116] The requirement to conform with GAAP extends to registration of mutual funds as well.[117] The transparencies mandated by the SEC extend to both the exchanges where securities are traded[118] and to the individual companies traded on those exchanges.[119] This system of complete transparency helps protect investors like no other securities regulation scheme in the world today.[120]

B. *Overseas Funds in the United States*[121]

Investors in overseas mutual funds are subjected to a significant risk exposure based upon the nature of the funds' investments in foreign capital

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[110] *Id.* at 36.
[111] *Id.* at 405-38.
[112] *Id.* at 449-97.
[113] *Id.* at 497-541.
[114] *Id.* at 541-89.
[115] 17 C.F.R. § 240.10b-5 (1998).
[116] *Id.* § 210.4-01 (1998).
[117] *Id.* § 210.3-18 (1998).
[118] "The SEC has thus identified "transparency," or equalization of information about prices, quotations, volumes, orders, and similar information, as a key regulatory goal." Paul G. Mahoney, *Technology, Property Rights in Information, and Securities Regulation*, 75 WASH. U.L.Q. 815, 845 (1997).
[119] Louis Lowenstein, *Financial Transparency and Corporate Governance: You Manage What You Measure*, 96 COLUM. L. REV. 1335, 1340 (1996).
[120] *Id.* at 1335.
[121] "Overseas mutual funds" includes the following types of mutual funds: 1) International funds, these funds invest only in securities of non-U.S. issuers; 2) Global funds, these funds invest in securities of both domestic and foreign issuers; and 3) Country funds, these funds invest in securities of foreign issuers located in a single jurisdiction or country. S. Jane Rose, *The New Wave of International Funds*, 582 PCI/CORP 123, 126 (1987).

markets.[122] Overseas mutual fund disclosure statements will often delineate, in great detail, the general risks associated with purchasing shares in the fund.[123] Among the factors often listed are: (1) the volatility of exchange rates due to the forces of supply and demand, foreign government intervention, and market speculation;[124] (2) the risks associated with political and economic uncertainty in many foreign jurisdiction due to the potential for confiscatory taxation, general instability, lack of U.S.-type regulatory oversight and disclosure of the financial condition of foreign corporation;[125] and (3) the fact that foreign markets are often less liquid which can lead to greater price volatility of a portfolio's securities.[126]

The risks of investing in overseas mutual funds has been particularly acute in funds which include securities from Asia to any large degree.[127] The region witnessed radical exchange rate devaluation,[128] bank failures,[129] and periods of social and political unrest, [130] all during the last half of 1997. All of these problems were exacerbated by a lack of financial transparency in both the government and private sectors.[131] At a minimum, the adoption of internationally accepted accounting standards[132] (hereinafter "IAS") by these countries would have provided investment decision-makers with the financial information necessary to make informed choices. For example, South Korea has its version of Generally Accepted Accounting Principles ("GAAP"),[133] but they deviate

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[122] An example of a risk disclosure is "RISK CONSIDERATIONS: The net asset value of the Fund's shares will fluctuate with changes in the market value of its portfolio securities and foreign currency rate fluctuations. The market value of the Fund's portfolio securities will increase or decrease due to a variety of economic, market or political factors which cannot be predicted." DEAN WITTER GLOBAL ASSET ALLOCATION FUND, FORM N-1A REGISTRATION STATEMENT, at 10, (Dec. 23, 1997), *available in Securities and Exchange Commission Homepage* (visited May 13, 1998) <http://www.sec.gov/Archives/edgar/ data/931988/0000950136-97-001860.txt>.

[123] *Id.* at 11.

[124] *Id.*

[125] *Id.*

[126] *Id.*

[127] During the second half of 1997, stock exchanges throughout most of Asia lost significant percentages of their total value (Hong Kong (39%), Indonesia (33%), Malaysia (47%), Philippines (30%), South Korea (25%)). *International Economy: Asia, supra* note 25.

[128] Thalif Deen, *Finance: Global Investors Retain Confidence in Asia*, Inter Press Service, Mar. 22, 1998, *available in* LEXIS, News Library, Curnws File.

[129] *Id.*

[130] *Economy / Researchers Urge Policy Revamp to Meet Targets Act Now, Don't Wait for IMF, Says Chalongphob: Prompt Moves Would Send Right Signals*, BANGKOK POST, Jan. 30, 1998, *available in* LEXIS, News Library, Curnws File.

[131] Fischer Address, *supra* note 13.

[132] International accounting standards ("IAS") are promulgated by the International Accounting Standards Committee (established in 1973). The IAS's have no independent force behind them until they are adopted by individual countries. COOPERS & LYBRAND, *supra* note 83, at IAS-1.

[133] *Id.* at K-1.

significantly from the IAS.[134] Indonesia has adopted its own version of accounting standards ("PAI") which fail to conform with the IAS in many significant ways.[135] Additionally, Indonesia has yet to formulate any general audit and reporting requirements, but audits are required for companies listed on their stock exchange.[136] Thailand was in the process of implementing accounting standards intended to meet IAS when the crisis occurred.[137]

Investors may feel that they were misinformed or misled regarding the risks they were assuming and wish to sue their mutual fund companies, and/or the fund's managers, for losses they sustained as a result of the crisis in Asia. They will have difficulty winning their suits, however, because the events which took place in Asia were ones falling among those risks likely to have been disclosed to the investor.[138] This difficulty was experienced by a group of investors when they attempted to recover losses suffered as a result of the Mexican peso crisis in 1994.[139] The district court found that the fund had sufficiently disclosed the risks associated with the fund's investment in Mexico and granted defendant's motion to dismiss.[140] The investors were essentially told that they had been provided all of the protection mandated by law by the mere disclosure of generalized risks associated with international investing.[141]

C. *The Impact of the Crisis on U.S. Investors*

At the end of 1996, mutual funds in the United States had a total asset value of over three and one-half trillion dollars.[142] This investment level is an

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[134] Some of the deviations are in how accounting is done for joint ventures, government grants and assistance, and taxation. *Id.* at K-20-21; The chaebols have failed to adhere to generally accepted accounting practices by not releasing comprehensive financial statements and by subsidizing loans across subsidiaries. Evelyn Iritani, *S. Korean Firms Announce Reforms; Asia: Four Major Conglomerates Vow Sweeping Changes that Would Reduce Their Control Over Ailing Economy*, L.A. TIMES, Jan. 13, 1998, at A8.

[135] COOPERS & LYBRAND, *supra* note 84 at I-44.

[136] *Id.* at I-28.

[137] Thailand is formulating Generally Accepted Accounting Principles in conjunction with their overall process of financial system modernization. *The Securities and Exchange Commission of Thailand and the Thai Capital Market*, *supra* note 75.

[138] *See* DEAN WITTER, *supra* note 122.

[139] In 1994, the Mexican government stopped supporting the peso's exchange rate and allowed it to float against the dollar. This caused the peso to devalue by over 15% against the dollar and led to a sharp depreciation in the value of Mexican securities held mutual funds. *In re* Alliance North America, No. 95 Civ. 0330, 1996 WL 551732 (S.D.N.Y. Sept. 27, 1996).

[140] *Id.*

[141] *Id.*

[142] INVESTMENT COMPANY INSTITUTE, MUTUAL FUND FACT BOOK 1 (1997).

increase of over twenty-five percent from the previous year.[143] Mutual funds have become the second largest financial intermediaries in the United States in terms of total asset value, behind only commercial banks.[144] In 1996, investment funds which focus primarily on investing in equities accounted for almost half of the total investment value held in mutual funds.[145] This level of investment is a thirty-eight percent increase in total value from the previous year.[146] Half of the increase in asset value has been due to appreciation of the portfolio assets.[147]

The mutual fund industry has also seen a tremendous increase in the amount of money United States citizens have invested in overseas funds over the last fifteen years.[148] Total assets in overseas funds now totals three-hundred and twenty-one billion dollars.[149] This amount is roughly one-tenth of the total mutual fund assets invested in the U.S.[150] Foreign emerging capital markets have also seen substantial growth in their relative importance.[151] In 1995, these markets accounted for almost eleven percent of the world's total market capitalization,[152] compared to just under four percent in 1986.[153]

The equity crisis in Asia has had a substantial impact on investors throughout the world, Alan Greenspan recently stated:

> Asian equity losses, including Japan, since June 1997 worldwide are estimated to have exceeded $700 billion of which more than $30 billion has been lost by U.S. investors. Substantial further losses have been recorded in bonds and real estate.[154]

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[143] *Id.*

[144] *Id.* at 2.

[145] Mutual funds emphasizing equity investment had asset values totaling 1.751 trillion dollars in 1996. *Id.*

[146] *Id.*

[147] *Id.*

[148] The amount of cash flowing into overseas mutual funds grew from a total of $900 million in 1984 to 46.3 billion in 1996. *Id.* at 4-5.

[149] *Id.* at 46.

[150] Total assets invested are 3.5 trillion with overseas fund assets accounting for 321 billion, or roughly ten percent *Id.* at 1, 46.

[151] *Id.* at 47.

[152] *Id.*

[153] *Id.* This data is compiled from the year ending in December 1996 and will undoubtedly show significant change when the 1997 numbers are published.

[154] Alan Greenspan, Hearing Before House Comm. on Banking and Financial Services, (Jan. 30, 1998) *available at* 1998 WL 8991405.

These losses were driven by the collapse of the equity market in Asia during the last half of 1997,[155] and by the devaluation of currencies throughout the region.[156] Uncertainty in the Asian markets has led to significant withdrawal of capital by mutual fund investors.[157]

Investors owning shares in certain individual Asian-based mutual funds have been devastated by the crisis. Merrill Lynch's Emerging Tiger Fund[158] lost nearly one half of its total asset value during 1997.[159] This performance was similar to that seen in Prudential's Pacific Growth Fund which saw its price swing during the last year from a high of seventeen dollars and twenty cents to a low of eight dollars and seventy-seven cents—a decrease of forty-nine percent.[160] Merrill Lynch's Developing Capital Fund and Pacific Basin Fund, Putnam's Asian Pacific Growth Fund, and Nomura's Pacific Basin Fund all saw substantial losses last year as well.[161]

IV. THE UNITED STATES' ROLE IN THE SOLUTION

A. *The IMF*

The IMF came into existence on July 22, 1945, at a conference held in Bretton Woods, New Hampshire.[162] On July 31, 1945, the United States

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[155] Some examples of the losses sustained between June 1997 and January 1998 are Hong Kong (39%), Indonesia (33%), Malaysia (47%), and South Korea (25%). *International Economy: Asia*, *supra* note 25.

[156] Edward Wyatt, *The Market Turmoil: The Investors; Despite Market Turmoil, Cash Keeps Pouring Into Mutual Funds*, N.Y. TIMES, Nov. 14, 1997, at D1.

[157] "According to UBS Securities (East Asia) Ltd., U.S. investors pulled a net US$38.2 million out of 98 U.S.-registered Asian mutual funds in the week ended Oct. 22, [1997]. That brought the total outflow from Asian mutual-fund sector to US$1.2 billion so far this year." Pui-Wing Tam, *As Markets Dive, Stock Sales Spur Redemptions, Sparking More Sales*, ASIAN WALL ST. J., Oct. 28, 1997, *available in* 1997 WL 14695800.

[158] The Emerging Tiger Fund is a mutual fund which invests primarily in emerging market countries in the Pacific Basin like Thailand, China, Indonesia, etc. MERRILL LYNCH EMERGING TIGERS FUND, INC., PROSPECTUS (1998).

[159] The fund lost an average of approximately 50% across the four classes of shares. Merrill Lynch, *Merrill Lynch OnLine* (visited May 13, 1998) <http://www.plan.ml.com>.

[160] *DBC Online*, *supra* note 7.

[161] Some examples of losses are Merrill Lynch's Developing Capital Fund (high-$17.91 low-$11.04 loss-38%), Pacific Basin Fund (high-$26.84 low-$16.49 loss-38%), Putnam's Asian Pacific Growth Fund (high-$14.86 low-$10.26 loss-31%), and Nomura's Pacific Basin Fund (high-$15.47 low-$9.40 loss-39%). *DBC Online*, *supra* note 7.

[162] It is often referred to as the "Bretton Woods Agreement." The World Bank was created at that time. International Monitary Fund, *Over Half a Century of Challenge and Change: Highlights of the IMF's Evolution*, (visited Mar. 29, 1998) <http://www.imf.org/external/pubs/ft/survey/sup0997/14chrono.htm>.

passed legislation authorizing the President to accept membership into the IMF on behalf of the United States.[163] The Articles of Agreement were signed in Bretton Woods, and went into effect on December 27, 1945.[164] The IMF began actual operation on March 1, 1947.[165]

The IMF's Articles of Agreement expressly state the purpose for the Fund's existence.[166] That being: (1) to promote international monetary cooperation and to provide support on international monetary problems; (2) to facilitate trade and economic expansion throughout the world; (3) to promote exchange stability among its members; (4) to assist in the establishment of a multilateral system of payments for current transactions among members; and (5) to help members by making the general resources of the Fund available to them *under adequate safeguards*, thus allowing them to fix their balance of payment problems without causing serious harm to international prosperity.[167]

The IMF's general resources exist as the result of deposits, referred to as quotas, made into the Fund by member nations.[168] The original quota levels were established by the Articles of Agreement, and are subject to change by a vote of an eighty-five percent majority of the total voting membership.[169] This increase in quotas is subject to the member states individually agreeing to the new amount of their quota.[170] The IMF's Board of Governors recently adopted a resolution increasing the total quota amount by forty-five percent over its previous level.[171]

The United States portion of the quota increase equals fourteen and one-half billion dollars.[172] Recently, President Clinton has also asked for a three and one-half billion dollar contribution to a special line of credit to be used by the Fund in certain emergencies.[173] Despite the fact that the quota increase is not technically an expenditure incurred by the United States[174] and

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[163] The only condition placed upon the authority to accept membership by the President was that a copy of the Articles of Agreement of the Fund be deposited in the archives of the Department of State. 22 U.S.C.A. § 286 (West 1998).

[164] International Monitary Fund, *supra* note 162.

[165] *Id.*

[166] International Monetary Fund, *Articles of Agreement of the International Monetary Fund*, (visited March 29, 1998) <http://www.imf.org/external/pubs/ft/aa/index.htm>.

[167] *Id.* art. I (emphasis added).

[168] *Id.* art. III

[169] *Id.* art. III, § (2)(c).

[170] *Id.* art. III, § (2)(d).

[171] *Board of Governors Adopts Quota Resolution; Members Must Take Steps to Consent to Increases*, IMF SURVEY, Feb. 9, 1998, at 38, 38.

[172] *The Fight to Fund the Fund*, *supra* note 64, at 25.

[173] *Id.*

[174] *Id.*

the money lent by the IMF will be paid back with interest,[175] the United State's Congress has delayed approving the money requested by President Clinton.[176] Opposition to the increased quota has come from both the political left and right.[177] The right is hoping for an opportunity to require reforms within the IMF as a condition to the new quota.[178] It is also unhappy with the money being used to support economies which compete with the United States, and they believe the government should not be intervening in the world's financial markets.[179] The political right also does not like the idea of the funds being used to bail out banks who made bad lending decisions.[180] The left on the other hand does not like the money being used to support governments who do not meet standards of behavior concerning human rights.[181]

B. Domestic Solutions

If the United States Congress is concerned about requirements the IMF places upon nations who receive loan packages,[182] one way it can affect those changes more quickly and with less international controversy[183] is by passing domestic legislation which would impose upon mutual funds a requirement to increase the level of disclosure concerning the financial position of the equities in their portfolio. The intent of more detailed disclosure requirements would be to create additional information which would allow investors to make more accurate risk assessments. Accurate risk assessment would lead, in theory, to an increase in investment in mutual funds whose portfolio securities meet minimal levels of transparency.

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[175] Harry Dunphy, *US: World Bank Chief; Approval of New IMF Funding is Essential*, AAP Newsfeed, Mar. 26, 1998, *available in* LEXIS, News Library, Curnws File.

[176] Nancy Dunne, *Congress to Delay New IMF Funding*, FIN. TIMES (LONDON), Mar. 4, 1998, at 7.

[177] Laura D'Andrea Tyson, *If There Were No IMF, They'd Have to Invent One*, BUS. WEEK, Mar. 9, 1998, at 21.

[178] Included in the reform measures is a provision in the Senate's bill requiring the lowering of trade barriers by countries receiving loans, and a measure in the House's version includes language requiring nations receiving loans to place limits on abortions. Lorraine Woellert, *Senate OKs Funds for IMF; House Plans Abortion Curb*, WASH. TIMES, Mar. 27, 1998, at A4.

[179] Tyson, *supra* note 177.

[180] *The Fight to Fund the Fund*, *supra* note 64.

[181] Tyson, *supra* note 177.

[182] *See supra* notes 177-82 and accompanying text.

[183] The unwillingness of the United States to readily increase its quota has led to international criticism about its leadership on economic issues. For example, "[y]ou cannot claim to be a world power . . . [or] have a free trade system, equity and stability around the world without (the U.S.) fulfilling obligations." Harry Dunphy, *supra* note 175 (quoting James Wolfensohn, President of the World Bank).

Another possible solution would be to regulate directly the types of equities in which mutual funds are allowed to invest. The direct regulation of mutual fund investment would make it illegal for U.S. mutual funds to invest in companies whose principle place of business is in a country that does not live up to the financial reporting standards imposed within the legislation. Congress could begin with a requirement that all securities owned within a mutual fund's portfolio meet the requirements established by the International Accounting Standards Committee for generally accepted international accounting and reporting standards.[184]

1. Asia

One of the explanations given for how Asia came to be in such a desperate situation is that the region generally lacks financial transparency.[185] This lack of transparency exists not only in the corporate and financial sectors,[186] but in the government as well.[187] The lack of transparency has contributed to more than just the cause of the crisis, it has also made efforts to fix it much more complicated.[188] The IMF has made the increase in financial transparency within the recipient countries one of the primary cornerstones to its Asian relief programs.[189] Whether full transparency can ever actually be attained in these countries is a question to be answered at a later time. For the purposes of this Comment, it is assumed that while transparency may never be fully achieved, any progression toward that end is worthy of programs aimed at improving investor protections through increased financial transparency.

U.S. investors sustained substantial losses as a result of the crisis in Asia.[190] The only information investors had regarding the risk of their investments in the troubled Asian countries was in the form of boiler plate language buried in the middle of the fund's prospectus.[191] When read from the view hindsight provides after the crisis in Asia took place, it appears that the risk disclosure statements in a fund's prospectus essentially say that there will be no

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[184] For a general discussion of the International Accounting Standards Committee and the IAS's promulgated by it, see COOPERS & LYBRAND, *supra* note 83, at IAS-1-26.

[185] Kalathil, *supra* note 6.

[186] *Seoul, IMF End First Round of Talks, Initial Bailout to Come This Week*, Agence Fr. Presse, Nov. 30, 1997, *available in* LEXIS, News Library, Curnws File.

[187] *Transparency Needed to Boost Public Trust*, JAKARTA POST, Nov. 17, 1997, *available in* LEXIS, News Library, Curnws File.

[188] Fischer Address, *supra* note 13.

[189] Camdessus, *supra* note 59.

[190] Greenspan, *supra* note 154.

[191] *See* DEAN WITTER, *supra* note 122.

disclosure about the actual underlying financial positions of the companies held in the fund.[192] Surely, a publicly traded U.S. corporation would not meet its reporting requirements if it made a disclosure to the Securities and Exchange Commission, and the general public, in which it stated that its financial statements were likely to be either non-existent or completely inaccurate. Yet, this is exactly the type of company in which an overseas mutual fund is allowed to purchase shares with funds from U.S. investors.[193] When a mutual fund invests in United States securities and subsequently reports its major holdings to the SEC and its shareholders, the shareholders then have the opportunity to independently determine the wisdom of those investments and can then change funds if they do not like the fund's investment choices. With an overseas fund, many of the securities held within the fund and reported to its shareholders cannot be independently evaluated because those company's financial information is not available, nor is it required to be disclosed to shareholders. The lack of information denies the fund's shareholders the opportunity to make an evaluation and to alter their investment decisions if they disagree with the fund's specific investment choices.

Congress has provided exceptional mechanisms for protecting individuals who invest in securities traded within the United States in the form of the Securities and Exchange Acts of 1933 and 1934,[194] and the Investment Company Act of 1940.[195] Congress has ensured almost complete transparency of United States corporate securities,[196] and has established significant disclosure requirements over the management and operation of mutual funds.[197] Congress has not yet, however, taken the steps necessary to protect U.S. investors whose money is used to purchase nearly unregulated securities which are held in the portfolios of overseas mutual funds.

The adequate protection of United States overseas mutual fund investors cannot be achieved through the general disclosure of risks which are involved in virtually all overseas investing. This general disclosure is exactly the type that currently exists in the prospecti of overseas mutual funds.[198] The devastating losses sustained by United States investors in Asia[199] and the extent those losses were reflected in falling mutual fund share prices truly demonstrated how

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[192] *Id.*
[193] *Id.*
[194] 15 U.S.C. § 78a (1994).
[195] 15 U.S.C. § 80a (1997).
[196] *See supra* notes 194-95 and accompanying text.
[197] 15 U.S.C. § 80a-1 (1997).
[198] *See* DEAN WITTER, *supra* note 122.
[199] *Implications of Asian Financial*, *supra* note 154.

vulnerable United States investors were to the risks associated with investing in unregulated securities markets. Given the losses incurred by investors, the current system of securities and mutual fund regulation has not performed its stated objective of protecting investors.[200]

2. *Solutions*

One way of achieving greater investor protection would be through United States legislation requiring detailed disclosures by mutual funds as to the nature and extent of the financial information available regarding the assets held in its portfolio. A simple way of doing this would be for the fund to list the securities in its portfolio which meet internationally accepted accounting standards, and which securities do not meet those standards. Investors who seek lower risk would be able to see from a fund's disclosures whether its investment policy was to invest in securities which do not meet IAS. The investor could then choose to move their money into funds which report a greater percentage of their holdings in companies adhering to IAS. A lower risk tolerance by a significant number of investors would increase demand for mutual funds who's investment policy provided the additional protection of IAS.

The increased capital flow into those funds with lower risk would lead corporations who wished access to that capital to improve their accounting practices so as to be considered candidates for that fund's investment. The increased transparency provided by these corporations would be good for every investor holding securities in those corporations. This solution, however, would impose an extremely high burden on mutual fund managers. They would be required to regularly determine whether each company in their portfolio was actually complying with the transparency requirements the fund promised to its shareholders.

A more dramatic and effective solution would be for Congress to pass legislation which would establish a minimum level of accurate and complete financial information required to be present before a publicly traded mutual fund could purchase securities in any company. This plan could be accomplished in the international context by determining which country's capital markets provided adequate safeguards for ensuring the transparency of the securities traded, and allowing only the securities from those counties to be held in a mutual fund's portfolio. The plan would

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[200] 15 U.S.C. §§ 78b, 80a-1 (1997).

force countries who wished access to the tremendous sums of capital available through direct investment by United States mutual funds[201] to take the steps necessary to meet the established requirements if they wished to maintain their desired levels of foreign investment. This level of protection for investors against unreasonable risk associated with securities trading is consistent with the current state of securities regulation in the United States[202] and should be extended to the protection of investors in mutual funds.

While looking out for the security of United States' investors, Congress would also be helping to ensure the success of the IMF programs instituted in Asia. They could do this by setting the minimal amount of acceptable information necessary to allow mutual fund participation in foreign capital markets, equal to those requirements outlined in the IMF programs.[203] The establishment of a prohibition against mutual fund investment in countries without adequate financial transparency would provide those countries with a powerful incentive not only to improve their financial transparency for the purposes of maintaining their IMF financing, but also to improve their financial reporting standards to be eligible to receive all of the direct investment available from United States' mutual funds.

V. CONCLUSION

The financial crisis in Asia has had a devastating effect on the lives of those living within the troubled countries as well as investors whose resources and wealth were tied into those economies. The United States has done a remarkable job in protecting its citizens from unjustified investment risks in every area except in the international arena. The current disclosure requirements imposed on mutual fund companies do not adequately protect investors from preventable risk. This problem can be solved through legislation, tailored in conjunction with the requirements imposed by the IMF, which would provide investors with the information necessary for them to make truly informed investment decisions.

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[201] INVESTMENT COMPANY INSTITUTE, *supra* note 142, at 46.

[202] 15 U.S.C. § 78 (1997).

[203] *See supra* notes 4, 86.