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Mutual Funds In Italy†

Until recently, substantial numbers of shares in mutual funds created outside of Italy were sold in that country. Since the beginning of 1969, however, the Italian government has imposed severe restrictions on such sales which have had the effect of diverting Italian investments into other channels. Unfortunately there are no Italian mutual funds which can serve as alternative investment areas since, under present Italian law, it is impossible to create mutual funds as we understand them, except in certain limited circumstances. While there is legislation pending to fill the gap, there is no indication as to when the legislation will be passed.

Sale Of Foreign Mutual Funds In Italy

Italian foreign exchange regulations permit the purchase by Italian residents of foreign stocks and bonds provided they are listed on major foreign stock exchanges. The purchase takes place through the Bank of Italy, or another Italian bank entrusted by the Bank of Italy to operate for it, and the securities purchased are held on deposit in an Italian bank or in a foreign bank abroad in the name of an authorized Italian bank (Ministerial Decree of October 26, 1967). Until recently, by applying the above rules, Italian residents could purchase shares in closed-end mutual funds if the fund was listed. In the case of open-end mutual funds, whose portfolio included securities not listed on a major foreign stock exchange, the purchase could be effected only after obtaining authorization from the Ministry for Foreign Commerce.

In the few months prior to June, 1969, the regulations applicable to the purchase of stocks and bonds were modified to restrict the right of Italian

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residents to purchase shares in both open- and closed-end mutual funds. The restrictions were imposed because foreign mutual funds had been extremely successful in selling to Italians, and a large amount of private savings was flowing abroad, rather than being invested in the Italian stock market. In the first quarter of 1968, the capital balance of payments showed that this flow amounted to about $377 million, or an annual rate of $1.5 billion, while in the first quarter of 1969 it amounted to about $753 million, which increased the annual rate to $3 billion. The result was felt in the overall Italian balance of payments, and the Italian government decided to impose a series of restrictions on the export of capital.

Among the restrictions was the issuance of a circular (No. A-205) by the Italian Foreign Exchange Office on April 8, 1969, instructing the Bank of Italy and all Italian banks acting as its agent, that "the purchase by Italian residents of shares in closed-end or open-end investment funds is hereby subject to prior authorization by the Ministry of Foreign Commerce." The Currency Committee of the Ministry of Foreign Commerce has issued regulations which provide that a foreign mutual fund, to be qualified to sell its shares to Italian residents, must first obtain authorization from the Ministry. A petition must be submitted by the representative of the fund in Italy, who must be a resident of Italy. The petition must contain the following information: (a) the corporate characteristics of the investment management company; (b) the type of mutual fund managed by the management company (whether open-end or closed-end, etc.); (c) the capital of the fund; (d) the current composition of the portfolio of the fund. In connection with point (d), the Ministry requires that if the portfolio is so composed that 50% of its total value is invested in Italian securities, this be so stated. If this requirement cannot be met, then the petition must clearly state that the petitioner undertakes to invest in Italian securities, 50% of the money obtained from the sale of the shares in the fund.

The petition must be accompanied by the certificate of incorporation and by-laws of the management investment corporation, a list of its shareholders, and the regulations of the fund.

The Minister of Foreign Commerce, commenting on the new authorization policy, pointed out that: (a) it would provide greater protection for Italian investors by scrutinizing the reliability and capability of the organizations sponsoring the funds; (b) it would provide better coordination with the pending law on Italian mutual funds; (c) it would eliminate any discrimination between funds which are listed on foreign stock exchanges and those which are not, a factor which is not determinative of whether a fund is good or bad. (See "Il Sole—24 Ore" of April 16, 1969)

It is too early at this stage to determine what policy the Ministry of

Foreign Commerce will establish in the granting of authorizations, but there is no doubt that the Italian government now has the means to maintain strict control over the activity of foreign funds, since authorizations are granted for only six-month periods, and may be renewed only upon submission to the Ministry of whatever information it requires.

The requirement that at least 50% of the mutual fund's assets be invested in Italian securities has resulted in directing some of the savings of Italian stock markets. At the same time, however, the restrictions imposed may well push some of the foreign mutual funds to sell their shares to Italians in violation of the Italian foreign exchange regulations.

The Present Law

In common law countries, the creation of mutual funds is to a large extent made possible by the existence of a trust relationship between the investment management company and the individual investor. As the concept of trust is foreign to European legal systems based on Roman law, however, mutual funds which are created in Europe are based on more complicated and hybrid structures which, in most countries, are regulated by appropriate legislation permitting the creation of funds with characteristics similar to those in common law countries.

In Italy, such legislation has not yet been enacted, and, as a consequence, there is no legal structure which permits the creation of mutual funds as we know them. While investment management companies with fixed capital structures have existed in Italy for some time, they have never had great success. In effect, they are nothing more than stock corporations having as their purpose the investment in other productive corporations. They were created more with a view to providing positions of control in other corporations than investing for yield.

Italian legal scholars have attempted to devise more sophisticated forms of mutual funds by the use of various provisions of existing law, but thus far none of their theories has been given practical application.

The possibility of adopting the concept of a "participation in association" ("Associazione in participazione"—Articles 2549-2554 of the Civil Code) was considered, but then set aside because it would result in an investment company where the assets of the investors are merged with those of the shareholders of the investment management company.

Another proposed solution concerning the creation of Italian mutual funds based on the concept of mandate (Article 1703 of the Civil Code) was discussed in 1959 by Berardino Libonati in his work, "Holding and Investment Trusts", and has also been rejected. A mandate ("mandato") is a contract by which one party undertakes to transact one or more dealings

for another party (the principal). According to Libonati, a mutual fund could operate in Italy if each investor were to give "mandates without representation" to both the investment management company and to the bank where the securities are to be deposited, each mandate dependent on the other, with instructions to invest, sell, and reinvest the money in securities. In a "mandate without representation", the agent purchases in his own name but for the account of his principal. Although the investment company would purchase in its own name, the effects of the purchase would fall directly on the individual investors, and title to the securities would be in them. According to Libonati, this would create a situation similar to that existing in a common-law trust, because the investment management company would act, in effect, as the trustee, and the investors would have the equitable title (Libonati, *supra,* at pp. 354-355).

This solution, although proposed in 1959, has not found practical application in Italy, and as of today no mutual fund has been set up on that basis. As was pointed out by G. E. Colombo in "L'Investment Trust nelle esperienze e nei progetti europei", pp. 251-324, at 261, the flaw in Libonati's reasoning is in assuming that title to personal property purchased by an agent automatically and directly transfers from the seller to the principal and not to the agent.

With title vesting in the agent (the mutual fund manager) rather than in the principal (the investor), serious tax problems arise. If title to the securities purchased by the investment management, as agent, is automatically vested in the various investors-principals, then it could be argued that the withholding tax on dividends is for the account of each investor, and the latter would not be taxed on capital gains resulting from the sale of securities. However, if the ownership is in the investment management company, then the funds invested would be considered its assets and would be subject to withholding tax, and worst of all, to income tax on capital gains. Capital gains are subject to taxation in Italy when the taxpayer is in the business of purchasing and selling securities, which would be the case in an investment management company. Such taxation, denying as it would the conduit theory of the mutual fund, would make the setting up of the mutual fund definitely unprofitable and impractical.

Nor would a solution be found by applying the concept of a "mandate with representation", under which the agent purchases (or sells) in the principal's name and for the principal's account. In such case, certificates for the securities purchased by the investment management company would have to be registered in the name of the principal. As the principals would be an undetermined number of investors, this would not be possible. Nor would it be possible to have a simple blank endorsement made by the

depositing bank making the purchase, because, under Article 2023 of the Civil Code, endorsements must include the name of the endorsee (See Colombo, *supra,* p. 355).

Since none of the proposed solutions is practical, mutual funds will not be created in Italy unless and until new legislation is enacted.

Proposed Legislation

Bills permitting the creation of mutual funds were submitted in Parliament in 1962 (Bill submitted on July 13, 1962 by Representatives Annosino, Bina, et al.), and in 1964 (Bill submitted by the Government to the Senate on September 22, 1964). In 1966, the matter was inserted as a part of the general bill for the reform of the law on corporations. ("Bill concerning the reform of business corporations" prepared by a government-appointed committee, Articles 72-85).

None of these projects, however, was ever voted on. Although from a financial and economic point of view, the general consensus seems to be that the enactment of such a law is advisable and would do much to bring the savings of small investors into an economy which is badly in need of them, no political party wants to take responsibility for pushing such a bill through Parliament. Politically, the subject is dangerous because of the fear of being identified with capitalism and private big business. The result is that small Italian investors, having recently discovered the advantage of mutual funds, invest their money in foreign funds, and the greater part of that money leaves Italy through unorthodox channels.

The most recent bill was submitted in Parliament on December 5, 1968, by Senators Bolotti, Colleoni and Segnana. As it is the only one presently under consideration, and vastly improves the preceding versions, its provisions are examined briefly.

The bill provides that the establishment and management of a mutual fund may be promoted by financial corporations, fiduciary companies or corporations having as their specific purpose the setting up of mutual funds. Such promoting corporations must have a stock capital of not less than 500 million lire (about $800,000) (Article 1). The difficulty arising from the absence of the trust concept is overcome by providing that mutual funds will not have legal personality, and that their assets will be separate from the assets of the promoting or investment management corporation and from those of each shareholder. This relieves the assets of the mutual fund from obligations assumed by the management corporation for purposes other than those relating to the management itself. The rights and obligations of the shareholders would be governed by the Civil Code provisions relating to joint ownership *(comunione,* Articles 1100-1116) as

far as applicable. "As far as applicable" is important because otherwise a shareholder could at any time invoke Article 1105 of the Civil Code, which entitles each joint owner to participate in the management of the property jointly owned, or Article 1111 which provides that any joint owner may ask that the "comunione" be terminated at any moment (unless it is specifically provided that it may not be terminated for a period of time which may not exceed ten years) (Article 2).

At the time the mutual fund is created, a management advisory board must be set up which will have complete operating independence, both from the promoting management corporation and the individual stockholders. It must be composed of well-known professional experts in the field of security investments. The members of the management advisory board may not be members of the board of directors of the promoting investment management corporation in order to avoid the possibility that, through the choice of investments, the investment corporation become a holding company (Article 3).

The regulations of the mutual fund must contain specific information listed in Article 4 of the Bill. Shares in the mutual fund may be acquired not only by individuals, but also by non-business corporations or chartible institutions (Article 5), which is a step forward in relation to prior bills which limited participation to individuals only.

Article 7 of the bill sets forth the functions and the interrelationships among the three operating bodies of the mutual fund: the management company, which has a general organizing and administrative function; the advisory board, which has complete independence in its function of determining the investment policy and the composition of the fund's portfolio; and the depository bank, which has the functions of fiduciary custody of the securities and transfer agent. The rights and obligations of the management company and advisory board on one side and the individual investors on the other are governed by the mandate provisions of the Civil Code.

Any doubt concerning the management company's title to the securities purchased is removed by a provision of Article 2, which states that the fund has no legal personality and its assets are separate and distinct from those of the management corporation. Article 7 also prohibits the advisory board and the management company from (a) conducting speculative operations; (b) borrowing money or securities for any reason; (c) purchasing or selling securities long or short; (d) giving money on loan in any form.

The depository bank is jointly responsible with the management company and the advisory board for seeing that all operations are in accordance with law, the regulation of the fund, and any directive of the governmental body entrusted with the control of mutual funds (Article 7). The

function of watchdog over the activities of mutual funds rests in the Ministry of the Treasury in accordance with the directives of the Interministerial Committee on Credit and Savings (Article 13).

Article 8 of the bill would considerably limit the choice of securities in which funds may invest the money at their disposal. It may be invested only in bonds and stocks listed on the Italian stock markets, unless the fund's regulations specifically allow investment in foreign securities or unlisted stock. In the case of foreign listed securities, however, the amount so invested may not exceed 25% of the mutual fund's assets, a limit, however, which the Ministry of the Treasury may from time to time modify according to the needs of the national financial market or the balance of payments situation.

Investment in unlisted stocks would be limited to not more than 5% of the mutual fund's assets. The mutual fund would not be permitted to invest in other mutual funds or in shares or bonds issued by the investment management corporation. In addition, funds could not purchase securities issued by corporations in which the directors of the investment management corporation or members of the advisory board serve as directors (Article 8).

The fear that a mutual fund might become and operate as a holding company, thereby controlling business corporations, is allayed by a provision in Article 9 of the Bill which makes it illegal for a fund to own securities in one corporation in excess of 5% of the value of the mutual fund's assets, or in securities having voting rights in one corporation with a par value exceeding 5% of the total par value of shares with voting rights issued by the corporation.

Other articles in the Bill touch on the question of the valuation of the fund's shares and their redemption (Articles 6 and 7), the books which must be kept, and the information which must be furnished to the governmental watchdog body (Articles 11 and 14), the right to information on the fund's activities by the shareholders (Article 12) and tax provisions (Articles 18 and 19).

While the proposed legislation would provide a workable system for the operation of mutual funds in Italy, nobody knows when and if it will be enacted. In the meantime, an Italian who wants to invest in mutual funds must either resort to illegal channels, or be limited to those foreign funds which are willing to comply with the stringent rules now in effect.

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