# UNIVERSITÀ DELLA SVIZZERA ITALIANA

# FACULTY OF COMPUTER SCIENCE

# Master in Artificial Intelligence

# THE RISE AND FALL OF I.O.S.

# BERNARD CORNFELD AND ROBERT VESCO [2014]

* By:
* Heider Jeffer
* Alina Iordache
* Natalia KLimova
* Michaela Sandulescu
* Mara Andreea Nicolaescu
* Monica Luntraru Mandalina

# brief history of the mutual fund industry

Mutual funds have been spinning around the idea of pooling assets together for investment purposes for a long time and from their beginnings in the Netherlands in the 18th century they have been expanding and turned into a growing international industry with fund holdings accounting for trillions of dollars in the United States alone. However, they became the main attraction of the public just in the 1980s and 1990s when mutual fund investment hit record highs and investors were very attracted by incredible returns.

## In the Beginning

The origins of the investment funds are uncertain for historians. One alternative is that the close-­‐end investment companies launched in the Netherlands in 1822 by King William I as the first mutual funds while the other option refers to a Dutch merchant named Adriaan van Ketwich whose investment trust created in 1774 may have given the king the idea. Ketwich probably theorized that diversification would increase the appeal of investments to smaller investors with minimal capital. Eendragt Maakt Magt is the name of Ketwich’s fund and can be translated into ‘unity creates strength’. The next wave of near-­‐mutual funds starts with an investment trust launched in Switzerland in 1849, followed by similar vehicles created in Scotland in the 1880s.

The strategy of pooling resources and diversifying the risk through close-­‐end investments started also to be used in Great Britain and France and reached United States in the 1890s. The first closed-­‐end fund in the U.S was the Boston Personal Property Trust, formed in 1893. An important step in the evolution toward what it is known today as the modern mutual fund was the creation of the Alexander Fund in Philadelphia in 1907. This fund allowed investors to make withdrawals on demand and featured semi-­‐annual issues.

## The Arrival of the Modern Fund

The modern mutual fund arrived in 1924 and its entrance was made through the creation of the Massachusetts Investors' Trust in Boston. The fund went public in 1928, eventually spawning the mutual fund firm known today as MFS Investment Management. The Massachusetts Investors’ Trust was under the custody of State Street Investors which later, created its own fund in 1924 with Richard Paine, Richard Saltonstall and Paul Cabot at the helm. Saltonstall was also collaborating with three other colleagues in launching the first no-­‐load fund in 1928. The same year marked another important moment in the history of mutual funds, that is the launch of Wellington Fund. This was the first mutual fund to include stocks and bonds, as opposed to direct merchant bank style of investments in business and trade.

## The legal environment before the 1960`s and the Expansion of Mutual Funds

In 1929, 19 open-­‐ended mutual funds were competing with nearly 700 closed-­‐end funds. This dynamic changed when the stock market crashed in 1929 and the highly-­‐leveraged closed-­‐ end funds vanished and allowing the open-­‐end funds to survive.

The industry of mutual funds continued to expand so that at the beginning of 1950s, there were around 100 open-­‐end funds. Financial markets managed to overcome their peak in 1929 and by 1954 the industry of mutual funds started to have more credibility and added 50 new funds over the course of the decade. The 1960s saw the rise of aggressive growth funds, with more than 100 new funds established and billions of dollars in new asset inflows.

Throughout the 1960s hundreds of new funds were launched and this up-­‐going trend was finally cooled down by the bear market of 1969. Money flowed out of mutual funds as quickly as investors could redeem their shares, but the industry's growth later resumed.

At the time of the Crash, the mutual funds market was characterized by a weak regulatory framework. Back then, the majority of the offerings were closed-­‐end funds, which managers used to impel investors that wanted access to initial public offerings. More specifically, there was no separation between fund and sponsor and managers were using the fund to do all kinds of self-­‐ dealing. The self-­‐dealing was their method to swindle funds, which no one suspected because they were making so much money it did not matter.

But such practices were outlawed in the fallowing years and by the time of 1940`s the mutual funds industry became the most strictly regulated sector at the federal level. Since then, funds are subject to four federal securities acts:

1. The Securities Act of 1933, that covers the registration of fund shares, requires disclosure of the fund’s investment objective, yield, and operating procedures through a prospectus, and strictly regulates the contents of advertising.
2. The Securities Exchange Act of 1934 and the Regulations of the National Association of Securities Dealers Act which requires the registration of brokers and dealers with the Securities and Exchange Commission (SEC) and sets several requirements for the solicitation of shareholder votes and proxies in connection with shareholder meetings.
3. The Investment Advisers Act of 1940 requires the registration of all mutual fund advisers (other than banks or bank holding companies), prohibits fraudulent practices, and gives the SEC enforcement powers.
4. The Investment Company Act of 1940, written specifically to oversee mutual funds [[1]](#footnote-1). One of the primary objectives of the act is the protection of investors against abuses, and it contains specific requirements that the mutual fund be operated in the best interests of the fund's shareholders. The major provisions of the Act are summarized as follows:

* Registration and "full" disclosure of investment companies to prevent fraudulent abuses.
* The SEC and the shareholders must receive complete financial reports at least semiannually.
* To qualify as a regulated investment company, the fund must have at least 75% of its total assets invested in securities, with not more than 5% of its assets invested in the securities of any one issuer and not holding more than 10% of the voting securities of any one corporation.
* Securities and cash must be kept by either a bank or a broker who is a member of a national securities exchange.
* Restrictions on changing a mutual fund's investment policies without shareholder approval.
* The adviser's compensation needs the shareholders’ approval and must be annually approved by the board of directors.
* Prohibits conflict-­‐of-­‐interest transactions between the fund and its affiliates.

To determine if the regulatory requirements are met, the SEC:

* Reviews disclosure statements related to operating plans, management structure, financial condition and
* Conducts on-­‐site examinations in order to evaluate the funds' valuation techniques, investment activities, management functions, and sales and liquidations of shares.

In addition to federal registration, a mutual fund must register in and abide by the laws and regulations of each state in which its shares are sold. In other words, unless a fund is registered in a certain state, it cannot legally sell its shares there.

Set up under the Investment Company Act of 1940 also, the Custodian Banks were designed to prevent misuse of the fund's assets by the investment adviser. A custodian bank acts as a third party watchdog responsible for protecting investors' assets from any illegal activities of the fund manager. This legislation required investment companies to register with the Securities and Exchange Commission and to meet strict listing requirements. The services provided by the custodian include settling securities transactions, receiving dividends and interest, and making payments for the fund's expenses.

This extensive scheme of regulation at the federal level, under the supervision of SEC, imposes a strict discipline on mutual funds, one to which other security issuers are usually not subject. It is also designed to provide an important source of investor confidence in the integrity of the mutual fund market. Moreover, it should be noted that these SEC-­‐mandated investor protections apply to all fund shareholders and all mutual funds, regardless of the state in which they are incorporated and organized, where they or their advisors are located, or where fund shareholders reside[[2]](#footnote-2).

Even if believed to have appeared in Europe, the mutual fund industry had far more little popularity here than in the US, especially in past years. Around the 1950 only few countries like France, UK, Netherlands and Switzerland were familiar with the mutual fund investments, while in other European countries like Italy and Spain the mutual funds started to operate only at a later stage, around the 1970-­‐1980. As a consequence, the regulation of the mutual funds sector was very fragmented and less enforced than in the US.

Might these differences in regulation between US and Europe have been an advantage for Bernie Cornfeld and his business? Probably yes, because since the beginning he was continuously switching his location in order to escape strict regulation and to create a chain of relations difficult to track.

# “The brains behind the operation”

# The story of Bernard Cornfeld

Bernard Cornfeld was born in 1927 in Istanbul where his father, Leon, a Romanian actor, manager and film producer had his offices. His career ended when he fell through a faulty skylight in Istanbul, and he moved in 1930 to New York trying hard to make a living as a teacher of German literature. He died three years later, leaving behind his six years old son and his second wife, Bernard’s mother. Coming from an intellectual Russian-­‐Jewish family which had lost its wealth in the revolution, she was enduring the hardship stoically, having to work around 20 hours per day and more, she tried to instill ambition and the ethic of hard work into her son. Bernard Cornfeld, as a boy much loved and encouraged by his mother, he switched her Tsarist principles for radical politics claiming to have raised much money nickels and dimes for the Abraham Lincoln Brigade during the Spanish Civil War. In the election year 1948, he worked for candidate Norman Thomas, a socialist against Truman and Dewey and later even joined the revolutionary Socialist Youth League.

He went to Brooklyn College and there he managed to overcome his worst handicap, a stammer. With the help of Willard Beecher, a respected psychiatrist that persuaded him not to run anymore from the opportunities to speak in public, Bernard, with an incredible will-­‐power succeeded not only in overcoming the stammer but in building up his self-­‐confidence and formed his public persona. He graduated with a degree in psychology and did an MA in social work at Columbia University.

He started as a social worker and later switched to selling mutual funds for an investment house. At this time, the American stock market was changing, shifting from the traditional close-­‐ end investment companies which were losing venture capital to the new open-­‐end investment companies. The latter were investing in a variety of stocks focusing on the risk-­‐diversification strategies and on the belief that on average, stock values would always grow so that losses would be always lower than gains. For Bernard Cornfeld, convincing people of the great potential of the market and the overall advantages of mutual funds, turned out to be an easy task. Shortly after he started selling mutual funds for the Investors Planning Corporation, going from one office to another in the country’s largest skyscraper, Empire State Building in New York. As it turned out later, earning money wasn’t the only benefit of his job, but also the fact that he got an inside perspective on how mutual funds work. Only interested in short-­‐term advantages, most of the fund’s money managers were looking for fast-­‐growing new companies, where capital gains rather than steady income were their incentive to buy. The background of this attitude was the need to make up the loss to the investor of the funds' overheads, out of which their profit also had to come.

Even though he was well paid as a salesman, the will to explore less competitive markets took Cornfeld to Jack Dreyfus, a legendary fund manager, trying to convince him to start a new European dealership.

In 1956 he took matters into his own hands and went to Paris, starting his own company selling mutual funds, using his savings of a mere few hundred dollars. His targets were the large number of well-­‐paid American GIs in army camps throughout Europe. He recruited a sales team from American exiles, that needed a source of income and inspired them with the fallowing question: ’Do you sincerely want to be rich?’, convincing them that if the answer is ‘yes’ than he has the solution.

# The story of Robert Vesco

Robert Vesco was born in December 1935. The son of a Detroit car industry worker, his ambition from his earliest years was to become rich. After dropping out of high school, he set out on his own in a variety of jobs. In his twenties he started working for an investment firm. A voracious reader and very quick learner, he was a natural self-­‐promoter and self-­‐aggrandizer, with the hustler's ability to size up human weakness and human venality in an instant [[3]](#footnote-3).

During 1965, he transformed from a small operator into a business man with substance. Vesco borrowed money to buy interests in a variety of machine tool firms, which he merged into a company called International Controls Corporation, the vehicle for many of his subsequent adventures. Leveraging his ICC investment to the top, Vesco became a presence on Wall Street and a seriously wealthy man. But his ambitions were not confined to the United States.

# “0ne of the most lucrative confidence games of that era”

# The I.O.S. Scandal

By mid twentieth century, the mutual fund industry was beginning to boom, based on the increasing confidence of the investors after the Great Depression that followed the Market Crash of 1929. But even the highly regulated US market was confronted with some problems, regarding the fees charged by mutual funds. The up-­‐front commissions (around 8%), as well as high operating expenses, eventually led to many complaints at the SEC, particularly when low performance was taken into account also.

But Cornfeld saw a way around this, that being to incorporate outside the US, where the business wasn't as regulated and where he could appeal to those looking to avoid income taxes in the States. Being a fund salesman himself, Bernie Cornfeld was a brilliant marketer and knew how to take advantage of an opportunity, when he saw one. He set up his own company Investors Overseas Services (I.O.S.) and moved from New York to Paris at the beginning of the 1956, recruiting a large number of abroad living US citizens, who were on the search for an occupation. After being accused of illegal sales of American fund certificates in France, Cornfeld was forced to relocate his business in Geneva, with the funds incorporated in Canada.

Cornfeld quickly assembled a huge sales force of around 25,000 loyal salesmen, mostly full-­‐ time employees. He inspired his sales team with trademark: "Do you sincerely want to be rich?" The salesmen were basically selling door to door the mutual funds’ shares all around Europe and target group were short-­‐time and small investors: expatriate Americans and mostly former US military members. Later, their strategy included also wealthy abroad living businessmen, who were looking to avoid income taxes by transferring their money to offshore funds.

In the end of 1959 Cornfeld found a partner who had a necessary knowledge to run the administration. It was Edward M. Cowett – a young ambitious lawyer, who had specialized in security law and sometimes was active as advisor of Jack Dreyfus, a legendary fund manager.

On April 9, 1960, the I.O.S. was registered formally as a corporation, I.O.S. Ltd. The seat of the registered place of business in a tax heaven, Panama, was chosen for different strategic reasons. Apart from the fiscal advantages, the accounting regulation in case of offshore financial institution was considered to be rudimentary. Moreover, the laws protecting the capital investors were lacking consistency. IOS grew rapidly and was making money in variety schemes: set up its own bank, invested in real estate and insurance, in mining companies and a venture to explore oil in Alaska.

On the 5th of January 1961, the first fund owned by I.O.S. was presented in Luxembourg, the International Investment Fund (IIT). The IIT soon became very popular and the largest fund of I.O.S., gathering over 700 million $ in assets by the end of 1969 (half of which belonged to German

investors). In autumn 1962, Cornfeld and Cowett developed and launched a new idea – the Funds of Fund – a revolutionary investment and very profitable venture, which was simply an offshore mutual fund that invested exclusively in shares of other I.O.S. mutual funds. Cornfeld's fund managers were set high targets for growth which led to ever greater investment in junk bonds, the phenomenal growth of which was almost entirely caused by I.O.S.'s having twice as much money to invest annually as share issues were available in the American market. It was marketed with tremendous success, but in reality, when the market began to tank -­‐ at the end of 1968 -­‐ it suffered a huge decrease in performance. The “guaranteed dividends”, a key to the sales pitch, were actually paid out of capital – the well known Ponzi scheme.

I.O.S. was basically an American company trading in Europe, while slipping between regulations, was considered to be a European company in the US, successfully managing to evade close scrutiny by any government. And after 10 years I.O.S. became one of the world's largest financial organizations. It built up capital of $2.5 billion, while the whole fund industry was around

$50 billion in assets. Cornfeld's personal fortune was well over $100 million.

The corporate goals for growth were set very high -­‐ to hit $100 billion in the following decade. Moreover, I.O.S. had such irresistible opportunities and excessive capacities to invest (it had twice as much money to invest annually as share issues were available in the American market), that more and more speculative investments in junk bond were made.

By 1965 Fund of Funds had invested more than $450 million in American mutual funds, what gave a tremendous power to the company. That attracted the attention of the SEC which, that year, accused Cornfeld and I.O.S. of violating American securities laws. The limit imposed by Federal mutual fund law prohibited registered mutual funds in the U.S. of owning more than 3 percent of another fund, while I.O.S. owned as much as half of other funds. In 1967 under pressure of regulators the company settled SEC complaint and agreed to stop American operations as well as selling to Americans abroad. They also consented to limiting their purchases to 3 percent of any American mutual fund.

In February 1970 Bernie Cornfeld was invited by the prestigious financial journal Institutional Investor to address its national conference in New York, attended by the leading stockbrokers, bankers and money managers of the world. As the principal speaker, he prophesied a golden and continuing boom into the future, as ever more wealth was created by a dynamic world economy, fuelled by ever-­‐increasing investment.

Those were times of excessive optimism and soaring prices. Forced to cover some of its costs, I.O.S. went public. It was a hot IPO and every investor and even employees were eager to participate. Cornfeld's I.O.S. had a stock-­‐option plan in which employees at different levels could participate.

# I.O.S. Ltd. -­‐ Going Public

The securities transactions giving rise to this scandal go back to 1969. The securities were the common stock of I.O.S., Ltd., an international sales and financial service organization principally engaged in the sale and management of mutual funds and complementary financial activities organized under the laws of Canada, with its main business office in Geneva, Switzerland.

Prior to 1968 the stock of I.O.S. and its subsidiaries had been held by its organizer, Bernard Cornfeld, his associates, and their employees. Although Cornfeld had always been free to sell his

I.O.S. shares, and in fact had disposed of significant amounts of these over the prior nine year period, his employees had been denied the right to sell their holdings and no organized market for

I.O.S. shares existed. Within the company the price of the stock was set by a theoretical formula value and the stock was used as a means of partial compensation and was granted to employees as a performance incentive. This was commonly understood by the employees that the company would eventually be taken public and they might then cash in.

A plan was developed wherein each of I.O.S.'s principal subsidiaries would first separately be taken public and finally common shares of I.O.S. itself would be sold. In 1968 IOS floated 600,000 shares of one of its principal subsidiaries, I.O.S. Management Ltd., a Canadian registered concern. The shares were offered at $12.50, trade opened at $75 and by March 1969 they had reached a peak of around $180.

After this sale, partly because of its success but also because of the increasing dissatisfaction among salesmen that received an attractive offer from a new competitor, the original plan was abandoned. Now, the focus was on taking I.O.S. public as soon as possible and the planning of the offering was constrained by the framework set out in an Order Accepting Offer of Settlement entered by the SEC on May, 1967.

According to this stipulation, IOS and all its affiliates have to cease all sales of securities to US citizens or nationals, wherever located, except for offers and sales outside of the United States (and its territories, possessions or commonwealth subject to the jurisdiction of the United States) to officers, directors and full-­‐time personnel of IOS and its subsidiaries.

Three separate distributions of IOS common stock were proposed.

A primary offering of 5,600,000 newly issued shares underwritten by:

* two American banking houses, Drexel Firestone, Inc. and Smith, Barney & Co., having their principal offices in the United States but also in Europe
* four foreign underwriting houses, Banque Rothschild; Hill Samuel & Co. Limited; Guinness Mahon & Co. Limited; and Pierson Heldring & Pierson, having their principal offices abroad.

The 5,600,000 shares were sold under a prospectus outside the United States to foreign nationals residing in Europe, Asia and Australia. Prospectuses were printed abroad in English, French, and German and delivered to the purchasers outside the United States.

A secondary offering of 1,450,000 shares, underwritten by defendant J. H. Crang & Co., a Toronto investment house was made in Canada by a prospectus conforming to the laws of Canada and its provinces. All of these shares were sold in Canada and none was sold to Americans resident there.

The third distribution was a secondary offering of 3,950,000 shares by Investors Overseas Bank Limited of Nassau, the Bahamas, an IOS subsidiary (IOB).

The prospectus stated, as that of the Drexel Group, that the shares "are not being offered in the United States of America or any of its territories or possessions or any area subject to its jurisdiction" and was "being made to approximately 25,000 persons who are either

* Employees or sales associates of the Company,
* Certain clients presently holding investments in managed funds or other products of the Company, or
* Persons who have had a long-­‐standing professional or business relationship with the Company."

The offerings were made at the same price, $10 per share, and at approximately the same time. Each prospectus referred to the two other offerings. Reference was made to plans to list the IOS stock on various stock exchanges, none of these being in the United States. The Drexel Group and IOB prospectuses were substantially identical. Although the Crang prospectus was somewhat different insofar as compliance with particular Canadian securities regulations was sought, all three contained balance sheets of I.O.S. and various subsidiaries as of December 31, 1968, and income statements for the five years then ended. They also contained a report of Arthur Andersen & Co., an international accounting firm with its principal office in the United States, that fairly presented the financial condition of the company as of December 31, 1968.

The Drexel and IOB prospectuses stated that the offerings had not been registered under United States securities laws. The offerings were successful in the limited sense of being fully subscribed, but after stabilizing briefly at $14, the price of the shares drifted downward until April 1970 when it collapsed through the $10 level and three weeks later the shares apparently were virtually unsalable.

This ended up being a great loss for the purchaser, that was about to become even greater when IOS passed into the hands of Robert Vesco.

# The fall of I.O.S.

During 1970 though, an accountant working for I.O.S. found his way through the complex labyrinth of interlocked companies and their performance, and realized that the actual profits, after all the creaming-­‐off by salesmen, managers and the international overheads, were almost non-­‐existent, and that was before making provision for an enormous number of bad investments at a time when the peak caused by over-­‐ confidence was already over. There was no money to meet debts and the whole structure crashed, ruining investors everywhere.

Eventually, the stock market crashed, demolishing stocks value held by funds. Situation was aggravated by the fact that everyone was heavily leveraged. IOS wasn’t able to return dividends to investors, and its shares fell down from $18 to $12. Cornfield with other directors and some outside investors decided to form a pool and make a large purchase. But even after, the stock price sank to $2. That created panic among employees and key portfolio managers, who rushed to cash out. IOS found itself facing a deep liquidity crisis and in desperate need of rescue.

The ‘savior’ of I.O.S. was at that time Robert Vesco, the owner of the ICC conglomerate. Under the pressure from the board of directors, Cornfeld accepted the proposal of Vesco and so, by February 1971 Vesco was the new chairman of I.O.S. Vesco bought I.O.S. for less than $5 million and gained control of an estimated $400 million in funds. As it will turn out later, this was the peak of his career with everything starting to go down soon after.

# Robert Vesco – World’s most wanted fugitive

Just a month later, SEC ‘the stock market watchdog agency’ started to make investigations into ICC and although the process of obtaining incriminatory evidence was slow, Vesco was feeling the pressure and committed the second ‘lethal’ mistake. As on the political stage at that time the main event was Richard Nixon’s campaign for a second White House, he planned to use this in order to stop the investigations of SEC.

He came to know the people from Nixon’s Cabinet and then sent them money, an anonymous briefcase with $200,000 as cash donation, considering that in return they will ask SEC to cease the investigations against him.

The effect was actually the opposite. SEC intensified the investigation and accused Vesco of fraud and perjury and also of using IOS business to steel $220m. He was then faced with no other choice but run from U.S.A and never to come back, starting somehow his ‘fugitive career’.

First stop was in Costa Rica, where the president at that time Jose Figueres passed a law through which Vesco could not be extradited, receiving in return millions of dollars from Vesco for one of his farms.

In all these places, Vesco was granted refuge in return of some of his millions and this turns out to be ‘an expensive business’. Since by 1982, most of his fortune was gone, he speculate again the political and economic relations between states and found a country that could receive him: Cuba, as they had sealed off from US by a trade and political embargo.

About his life there, no real evidence exists but most of the speculations done might be true. One of these is that he was involved in drugs and trafficking and also in helping Cuba setting up companies to circumvent the US embargo. But, 1995 he was not useful for Castro either and was accused of being an agent of ‘foreign special services’ and ‘a provocateur’.

Sentenced to 13 years in jail, Vesco is said to have been released towards the end and consigned to informal house arrest. He is said to have died of lung cancer in November 2007 and was buried in a cemetery in Havana but in a tomb with another family’s name. No official announcement was ever made.

# Bernie Cornfeld – Life after I.O.S.

He was charged with fraud by the Swiss authorities when 300 employees of IOS complained that he and his co-­‐founders pocketed part of the proceeds of a share issue raised among employees in 1969. He was arrested in Geneva and served 11 months in a jail in Switzerland before being bailed out for $ 600,000 and never admitted being guilty, blaming just the other executives of the company. His trial took place in 1979 and lasted three weeks before the judge finally acquitting him.

Bernard Cornfeld was not, at least in intention or in his own eyes, a crook, but an entrepreneur with a big idea that went wrong. He was the creator of IOS a huge company controlling billions of dollars from investors, who had a great impact on both the American and the International stock market, leading in quite a significant extent to the financial crash of 1970, when the irrational excitement of investing suddenly faced an end.

He was a brilliant salesman who built the company by seeing an opportunity, taking it, speculate and then let it grow beyond his dreams and eventually beyond his control. He exploited greed and lived the euphoria of the ‘American dream’ with such an intensity that he could not conceive that what goes up can also come down and that the basic principles of running a business refer to other things except sales.

Returning to Beverly Hills, his lifestyle changed dramatically, being less ostentatiously than in his previous years. He was a chairman of a land development firm in Arizona and also owned a real estate company in Los Angeles. His marriage ended in divorce, and he is survived by a daughter. Bernard Cornfeld suffered a stroke and died of a cerebral aneurysm on February 27, 1995 in London, England.

# Conclusions: How the IOS scandal influenced the regulatory system thereafter

Fallowing the abuses of the off-­‐shore investment companies in the 1960’s and the collapse of the IOS, the Securities and Exchange Commission admitted to part of the blame for not attempting to expand into areas beyond the reach of the United States legislation [[4]](#footnote-4). Being free from the SEC regulation by setting up the funds outside the US and gathering funds from foreigners, the management of these investment companies engaged in business conduct and financial transactions that would have been prohibited under the Investment Company Act of 1940.

The first step in trying to set up the minimum standard rules for the international mutual fund industry was realized as a joint effort of the US, The European Community and the European Governments through the OECD (The Organization for Economic Cooperation and Development).

In 1970 the Investment Company Institute formed a Committee to address Foreign Market Regulatory Issues, that aimed at removing impediments that got in the way of portfolio investment abroad by the US funds, strengthening corporate governance in foreign markets and protecting the US funds’ rights as investors on behalf of their shareholders.

The new provisions of the Investment Company Act 1940 that became effective from June 14, 1972 were regulating the sales charges and withdrawal penalties from mutual funds and setting the maximum load fee that mutual funds can charge, but, at the same time, allowing a reasonable compensation to sales personnel, broker-­‐dealers and underwriters.

In a Time Magazine article from 1972 [[5]](#footnote-5) was said that also Switzerland had tightened its securities laws [[6]](#footnote-6) because of the scandals regarding I.O.S. They were preventing the selling ‘from a Swiss base’ of mutual funds that were not registered with the Swiss Federal Banking Commission. After that, in 1994, Switzerland has adopted the Federal Law on Investment Funds applied to collective investments and to foreign investment funds, whatever their corporate basis. This law required also the separation of Fund Management and Custody, the latter being supposed to exercise a supervisory role in relation to the fund manager, while having a statutory duty toward the investors.

At a European level, of particular importance was the introduction of the Council Directive of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS). UCITS are collective investment schemes, allowed to operate freely in the European Union on the basis of the

Authorization [[7]](#footnote-7) from a single member state. Their aim is to collectively invest capital raised from the public in transferable securities listed on a stock exchange or a similar regulated market, based on the risk-­‐spreading principle. Only the open-­‐ended funds raising capital by publicly promoting the sale of their units within any part of the EU are subject to this Directive [[8]](#footnote-8). This Directive assigns an important role to the depository institutions, supposed not only to safe-­‐keeping the UCITS assets but also to ensure that all transactions – such as sales, issues, repurchases, redemptions and cancellations of units – effected by or on behalf of the fund are carried out in accordance with the law and the fund rules.

Even with the strictest regulation, there are always some slick people that find a small deficiency of the system and exploit it in order to make a fortune. No matter if we speak about Bernie Cornfeld in the late 1960s, ESM and Bevill Bresler and Levine and Boesky in the late 1980s, Enron and WorldCom in the 2000s or the latest Bernard Madoff in 2008, they are all cases were the system lacked enforcement and the investors’ confidence was severely harmed. But they represent also cases were, understanding the problem and learning from their mistakes, regulatory authorities have been capable to update their laws and regulations by covering new fields and aspects.

Will there be any new cases of Ponzi schemes and fraud? Probably yes, but if they could be identified in time by the joint efforts of investors and regulatory authorities, the losses will be lower for both the financial markets and the investors.

# References:

1. <http://www.lowtax.net/lowtax/html/jswolaw.html#invest>
2. <http://www.electronpress.com/excerpts/vescoexc.htm>
3. <http://www.thefreelibrary.com/Recent+trends+in+the+mutual+fund+industry-­‐a014714669>
4. <http://stason.org/TULARC/investing/mutual-­‐funds/Mutual-­‐Fund-­‐Regulation.html>
5. <http://www.mysmp.com/mutual-­‐funds/custodian-­‐bank.html>
6. [http://www.capco.com/files/pdf/64/03\_INFRASTRUCTURE/04\_The%20European%20custo dy%20industry%20%20potential%20business%20strategies%20for%20future%20success.p df](http://www.capco.com/files/pdf/64/03_INFRASTRUCTURE/04_The%20European%20custo%20dy%20industry%20%20potential%20business%20strategies%20for%20future%20success.p%20df)
7. Rolf Weber and Seraina Gruenewald -­‐ UCITS and the Madoff scandal: liability of the depository banks?, Butterworths Journal of International Banking and Financial Law
8. <http://www.buyandhold.com/bh/en/education/history/2002/fund.html>
9. [http://www.nytimes.com/1995/03/02/obituaries/bernard-­‐cornfeld-­‐67-­‐dies-­‐led-­‐ flamboyant-­‐mutual-­‐fund.html](http://www.nytimes.com/1995/03/02/obituaries/bernard-­‐cornfeld-­‐67-­‐dies-­‐led-­‐%20flamboyant-­‐mutual-­‐fund.html)
10. <http://www.time.com/time/magazine/article/0,9171,916989,00.html>
11. [http://www.nytimes.com/2008/05/03/world/americas/03vesco.html?pagewanted=1&\_r= 1&th&emc=th](http://www.nytimes.com/2008/05/03/world/americas/03vesco.html?pagewanted=1&_r=%201&th&emc=th)
12. <http://www.portfolio.com/executives/features/2008/01/14/Robert-­‐Vesco-­‐Profile>
13. <http://www.thefreelibrary.com/Recent+trends+in+the+mutual+fund+industry-­‐a014714669>
14. <http://stason.org/TULARC/investing/mutual-­‐funds/Mutual-­‐Fund-­‐Regulation.html>
15. <http://www.mysmp.com/mutual-­‐funds/custodian-­‐bank.html>
16. <http://en.allexperts.com/e/b/be/bernard_cornfeld.htm>
17. <http://www.time.com/time/magazine/article/0,9171,878126,00.html>
18. <http://www.time.com/time/magazine/article/0,9171,903432,00.html>
19. <http://www.thehallofinfamy.org/inductees.php?action=detail&artist=bernard_cornfeld>
20. [http://www.independent.co.uk/news/obituaries/robert-­‐vesco-­‐fugitive-­‐from-­‐us-­‐justice-­‐for-­‐35-­‐ years-­‐822084.html](http://www.independent.co.uk/news/obituaries/robert-­‐vesco-­‐fugitive-­‐from-­‐us-­‐justice-­‐for-­‐35-­‐%20%20years-­‐822084.html)

1. Mutual Fund regulation : Forging a new Federal and State Partnership, Matthew Fink, Investment Company Institute, January 1996 [↑](#footnote-ref-1)
2. Mutual Fund regulation : Forging a new Federal and State Partnership, Matthew Fink, Investment Company Institute, January 1996 [↑](#footnote-ref-2)
3. http://www.independent.co.uk/news/obituaries/robert-­‐vesco-­‐fugitive-­‐from-­‐us-­‐justice-­‐for-­‐35-­‐years-­‐822084.html [↑](#footnote-ref-3)
4. October 18, 1971 – Annual mutual fund sales/management Conference [↑](#footnote-ref-4)
5. Time Magazine, `Mutual Funds : I.O.S. seeks a Home, Monday, the 3rd of April 1972 [↑](#footnote-ref-5)
6. Not publicly available [↑](#footnote-ref-6)
7. Authorization is given after the approval of the management company, the fund rules and the choice of the depositary [↑](#footnote-ref-7)
8. http://www.ufsp.uzh.ch/finance/documents/WeberGruenewald\_UCITSdepositaries.pdf [↑](#footnote-ref-8)