

Foreign Holdings and Transactions with Foreign Persons: Reporting Responsibilities of US Investment Managers

by Julien Bourgeois and Philip Hinkle

Last year, several US investment managers, including managers of registered investment companies and hedge funds, and also broker-dealers, received notifications from the Federal Reserve (Fed) regarding their obligations to file reports of their holdings of foreign securities and certain transactions with foreign persons. Those reports are used by the US Department of Treasury (Treasury), the Fed and the US Department of Commerce. For several of these investment managers, these notifications came as a surprise given that their primary regulator was the US Securities and Exchange Commission (SEC), not the Fed.

Investment managers should be aware that there is an intricate system of reporting requirements that can apply to them and that a failure to report could expose them to civil and criminal penalties. This article provides an overview of several of these reporting requirements and discusses situations affecting investment managers that the authors have

encountered in practice. The goal of this article is to help investment managers identify the reporting requirements applicable to them and begin establishing an appropriate compliance system.

Background

Three distinct reporting systems can apply to investment managers:

1. The Treasury International Capital (TIC) reporting system, which was established in 1934 to gather timely and reliable information

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on the levels of and changes in US international portfolio investment and capital positions. The TIC reporting system collects data on cross-border transactions in securities and other financial instruments and periodic data on cross-border holdings of securities. The Treasury, the Fed, and other organizations use this information to calculate the US balance of payments, to formulate US international financial and monetary policies, and to generate International Monetary Fund statistics.¹ All parties to cross-border transactions or holders of foreign securities, including investment managers who place trades on behalf of their clients, may be required to file TIC reports.

2. The foreign currency (FC) reports, which were established in 1973 to provide information on activities effecting the value of the US dollar. The FC reports gather data on foreign exchange positions and foreign currency denominated assets and liabilities of foreign exchange market participants. The Treasury and the Fed use this information to assess and monitor the foreign exchange spot, forward, futures, and options markets.² Investment managers that invest their clients' assets in foreign exchange contracts may be required to file FC reports.
3. The reports of the Bureau of Economic Analysis (BEA) of the US Department of Commerce were established in the late 1970s to gather information regarding transactions of

certain services and intangible assets between US and foreign persons. The BEA reports collect information on sales to and receipts from foreign persons of intangible assets and selected services, including payments of fees for the provision of financial services. The BEA uses this information to formulate international economic policy and analyze the impact of US economic policies on international transactions. Investment managers that receive fees from, or pay fees to, foreign parties for financial or advertising services, for example, may be required to file BEA reports.

Each of the TIC,³ FC,⁴ and BEA⁵ reports are authorized and required by an Act of Congress. There is potential civil and criminal liability for failure to file required reports. Any person that fails to file a required report may be subject to a civil penalty between \$2,500 and \$25,000. Any person that willfully fails to file a required report may be subject to a \$10,000 fine and imprisonment for up to one year. In addition, the filing requirements subject officers, directors, employees and agents of any entity with filing obligations to the same penalties.

Overview of TIC, FC, and BEA Reports

As is further explained below, certain investment managers may have to file some or all of these reports. (*See* Table 1.) This section provides

Table 1—Overview of Reports⁶

Reporting System Forms	Core Coverage	Potential Reporters
TIC B Forms	Snapshot of short-term securities and currencies claims on, or liabilities to, foreign persons	Banks, brokers and dealers and Bank Holding Companies/Financial Holding Companies (likely not investment managers)
TIC C Forms	Snapshot of financial or commercial claims on, or liabilities to, foreign persons	US residents other than TIC B filers (includes investment managers)
TIC D Form	Snapshot of cross-border derivatives contracts and related net settlement payments	US resident entities (includes investment managers)
TIC S Forms	Report of US or foreign long-term securities purchased or sold from or to foreign residents.	US resident entities (includes investment managers)
FC Forms	Snapshot of foreign exchange contracts and foreign currency liabilities	US residents (includes investment managers)
BEA Forms	Report of services transactions and transactions in intangible assets	US persons (includes investment managers)

further details regarding these reporting systems and summarizes the forms that may be applicable to investment managers. The number of reports identified below may be surprising and appear daunting, and compliance necessitates careful planning. It is the authors' experience, however, that establishing an organization-wide compliance policy to address the applicable reporting requirements is the best approach to avoid liability under these reporting systems.

TIC Reports

The TIC reports gather information on claims and liabilities between US residents and foreign persons. Both the entity that is required to report and the information that must be reported, however, vary from report to report. As explained below, investment managers should note that certain TIC reports are filed by broker-dealers that executed the securities transaction and thus do not apply to investment managers, but certain other TIC reports are filed by the investment managers, depending on the circumstances. Also, many of the TIC reports must be filed on a group-wide consolidated basis, which can lead to confusion regarding the appropriate reporter.

TIC B Forms

The TIC B forms of reports (Forms BC, BL-1, BL-2, BQ-1, BQ-2, and BQ-3) require all US-resident banks and other depository institutions, securities brokers and dealers, and bank holding companies/financial holding companies to provide a periodic snapshot of short-term securities (securities with a maturity of one year or less) and currency claims on and liabilities to unaffiliated foreign residents. All such persons with \$50 million in claims or liabilities (or \$25 million in claims in an individual geographic area) are required to report. It should be noted that the reporter must file one consolidated report for all its offices and subsidiaries, and that the appropriate reporter for an organization is generally the top-level bank or broker-dealer entity. Investment managers are generally not required to file TIC B reports.

TIC C Forms

Form CQ-1 requires US residents (other than the TIC B filers noted above) to provide quarterly snapshot reports of their *financial* claims on and liabilities to unaffiliated foreign residents. Form CQ-2 requires US residents (other than TIC B filers)

to provide quarterly snapshot reports of their *commercial* claims on and liabilities to unaffiliated foreign residents. A financial claim or liability imposes a right to receive or an obligation to pay cash, for example a loan or repurchase agreement; a commercial claim or liability arises between a seller and purchaser of goods or services in the normal course of business. A financial claim includes, among other things, short-term securities, money market instruments, brokerage balances, and cash collateral from securities lending activities. All US residents, including investment managers, other than TIC B filers, with \$50 million in claims or liabilities are required to report using the TIC C forms. The reporter must file a consolidated report for all of its offices and subsidiaries, including, in the case of an investment manager, each of its US-resident investment funds and accounts managed. As a result, an investment manager's report must state all of the reportable claims and liabilities of the US resident funds and accounts it manages in a single, entity-wide Form CQ-1 or Form CQ-2 report. Many investment managers of a certain size may have to file these reports.

TIC D Form

Form D requires major US-resident participants in derivatives markets (including investment managers, non-bank holding companies, and broker-dealers) to periodically report snapshot information regarding cross-border derivatives contracts.⁷ Form D tracks the levels of, and changes in, US international capital positions due to cross-border derivatives contracts and the related net settlement payments. An entity must only report if the total notional value of its cross-border derivatives contracts for its own and its customers' accounts exceeds \$100 billion at the end of the calendar quarter being reported.

An investment manager must file a Form D if the aggregate notional value of its (or its clients') cross-border derivatives contracts exceeds the \$100 billion notional reporting threshold. However, an investment manager is not required to report the cross-border derivatives contracts of any client if the investment manager was not acting as counterparty or transacting party (for example, broker-dealers) in entering a derivatives contract. As a practical matter, an investment manager must only report information on a client's derivatives transactions if the investment manager is acting as a broker, dealer or underwriter for its client's derivatives transactions.⁸

TIC S Forms

The TIC S forms (Forms S, SHC, SHCA, SHL, and SHLA) require certain US residents to report information regarding their transactions in securities with foreign persons, their holdings of foreign securities, and the US securities they hold on behalf of foreign persons. Of all of the different TIC S forms, investment managers are most likely required to file Form S.

Form S requires US-resident investment managers, non-bank holding companies, broker-dealers, and depository institutions to file monthly reports of the aggregate purchases and sales of long-term US and foreign securities (including public and private debt and equity securities, and mutual fund shares) between US and foreign residents. The reporting threshold is \$50 million in total long-term securities transactions during the reporting month. Form S is filed by the entity that *actually places* a long-term security order (that is, the US broker or dealer placing the trade), which makes it unlikely that an investment manager would be required to report unless the investment manager places trades directly with foreign broker-dealers.

Forms SHC and SHCA require all significant US resident custodians and investors (including investment managers to mutual funds) to file annual snapshot reports of their holdings of foreign securities on a security by security basis. The general reporting threshold is owning or holding in custody \$100 million in foreign securities, but the Fed has authority also to require entities that do not reach that threshold to report. Form SHC is a benchmark survey and is filed approximately every five years (as mandated by the Treasury and the Fed) and Form SHCA is filed on an annual basis in all other years. The custodian that holds the assets of the funds managed by an investment adviser generally satisfies the Form SHC and Form SHCA reporting requirements.

Forms SHL and SHLA require all significant US resident custodians and investors to file annual snapshot reports of their customers' and their foreign holdings of US securities on a security-by-security basis. All US residents that receive a copy of the Form SHL or SHLA from the Fed (generally US-resident custodians, US-resident central securities depositories, and US-resident issuers) must file these forms. Form SHL is a benchmark survey and is filed approximately every five years (as mandated by the Treasury and the Fed) and Form SCLA is filed on an annual basis by the largest reporters in all other years. The custodian that holds the assets of the funds managed by an

investment adviser generally satisfies the Form SHL and Form SHLA reporting requirements.

In practice, it is rare that investment managers must file the TIC S forms because the reporting system has been designed to minimize reporting by investment managers by requiring that US broker-dealers or custodians do most of the reporting. However, if an investment manager's subsidiaries provide custody services, the top-level organization, which may be the investment manager, must file a consolidated report for their entire organization, assuming they meet the applicable threshold levels of holdings. Also, placing trades directly with foreign broker-dealers may trigger filing requirements. Certain investment managers that had not considered their filing obligations realized after a review that they have to file TIC S forms after all, due to their use of foreign brokers to execute trades.

Treasury Foreign Currency Forms

Forms FC-1, FC-2, and FC-3 (together the FC forms) require US-resident investment managers, non-bank holding companies, broker-dealers, and banks to periodically report a snapshot of their foreign exchange contracts and foreign currency assets and liabilities. These reports are filed on a weekly, monthly and quarterly basis, respectively. The reporting threshold for Forms FC-1 and FC-2 is \$50 billion equivalent in foreign exchange contracts or currency assets and liabilities. The reporting threshold for Form FC-3 is \$5 billion equivalent in foreign exchange contracts or currency assets and liabilities. (For each, the threshold is measured on the last business day of any calendar quarter during the previous year.) For each of the FC forms, net options positions also must be supplied if the aggregate notional principal amount of options purchased and sold by the reporter exceeds \$500 million in equivalent specified currencies. Investment managers to investment funds that use investment sub-advisers should note that the investment managers, and not the sub-advisers, are subject to the reporting requirements for the funds' trades. Also, investment managers should note that, unlike certain TIC forms, reporting is required even if client assets are held by a US custodian.

Bureau of Economic Analysis Forms

Forms BE-185 and BE-80 are summary reports of financial services transactions between US financial services providers and foreign persons.

These forms require financial services providers (including investment managers) and intermediaries to report receipts and payments of fees, commissions, and other charges for any financial services, including brokerage services, underwriting and private placement services, financial management services, and financial advisory and custody services, among others. Financial services providers and intermediaries must report if they have receipts from foreign persons related to their combined financial services transactions in excess of \$20 million for the previous fiscal year or payments to foreign persons related to their combined financial services transactions in excess of \$15 million for the previous fiscal year (and must also report if these threshold levels are forecasted for the current fiscal year). It should be noted that fees paid by foreign persons for investment advisory services fall into this reporting category, meaning that certain investment managers (or their parent companies) may exceed the reporting threshold and need to file these forms. When an intermediary is involved, only the US financial services provider that directly deals with a foreign person should report the transaction. Form BE-80 is a benchmark survey that is required as directed by the US Department of Commerce and Form BE-185 is a quarterly report that is filed in all other quarters.

Forms BE-125 and BE-120 are summary reports of transactions in intangible assets and services with foreign persons. All US persons that had or expect to have sales in excess of \$6 million or purchases in excess of \$4 million with foreign persons for the previous fiscal year (or forecasted in the current fiscal year) must report on these forms. Other US persons also are requested to provide a report of such purchases and sales using estimated figures. Form BE-125 is a benchmark survey that is required as directed by the US Department of Commerce and Form BE-120 is a quarterly report that is filed in all other quarters.

Conclusion

Many investment managers are unaware that they may be subject to some of the reporting

requirements identified above. Investment managers should consider whether any of these reporting requirements apply to their organization and/or whether another part of their organization is currently preparing adequate reports. In our experience, identifying the applicable forms and accessing the necessary information may be a time consuming process at first, but is manageable if approached in a rational and organized manner. Also, once the reporting system is in place, it usually requires little follow-up involvement.

NOTES

1. See Instructions for Preparing the Treasury International Capital (TIC) B Reports, March 10, 2006, Instructions for Preparing the Treasury International Capital (TIC) C Reports, March 10, 2006, Instructions for Preparing the Treasury International Capital (TIC) D Reports, October 19, 2004, Instructions for Monthly Treasury International Capital (TIC) Form S and Memorandum, January 1, 2000, Report of Ownership of Foreign Securities (SHC and SHCA), July 2006, and Foreign Residents' Holdings of US Securities (SHL and SHLA), April 2005. Current reports of the TIC data are posted on the US Treasury Web site, www.treas.gov/tic. See also Carol C. Bertaut, William L. Grierer, and Ralph W. Tryon, "Understanding U.S. Cross-Border Securities Data," *Federal Reserve Bulletin*, Vol. 92 (May 2006), pp. A59-A75.
2. See TFC-1, -2 and -3, Background, October 4, 1999.
3. See 22 U.S.C. 286f; 22 U.S.C. 3103; E.O. 10033, as amended.
4. See 31 U.S.C. 128.1(a); see also Title II of Public Law 93-110; TFC-1, -2, and -3, Background, October 4, 1999.
5. See Section 5(b)(2) of the International Investment and Trade in Services Survey Act, 22 U.S.C. 3101-3108.
6. The Treasury, Fed and Department of Commerce administer other reporting systems, which, in the authors' experience generally would not apply to investment managers.
7. Only derivatives contracts that meet the Financial Accounting Standards Board (FASB) Statement No. 133 definition of a derivative contract must be reported on Form D. Such derivatives include, but are not limited to, certain forward contracts, certain futures contracts and options, and certain swaps.
8. Changes are proposed in Form D and the related instructions to be effective beginning as of March 2009. The proposal can be accessed at www.ustreas.gov/tic.

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