

Treasury adopting new reporting requirement regarding cross-border holdings that are applicable to US investment managers

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Many US investment managers and other parties will need to consider by June 30, 2011 whether they are required to report to the Federal Reserve Bank of New York monthly "snapshot" information on a new Treasury form, "TIC SLT." TIC SLT is a new part of the Treasury International Capital reporting system, which allows the US Department of the Treasury and the Federal Reserve to gather information on cross-border holdings and cross-border transactions. TIC SLT gathers information on US residents' holdings of foreign securities and foreign residents' holdings of US securities. Notably, an investment manager may be required to report as part of its TIC SLT (1) the foreign securities held by, and (2) the shares issued to foreign residents by, the US mutual funds and US private funds managed by the investment manager.

A "US resident" is any "individual, corporation or other entity that is incorporated or otherwise legally established in the United States, including branches, subsidiaries and affiliates of foreign entities located in the United States." A "foreign resident" is any "individual, corporation or other entity legally established outside of the United States, regardless of the actual center of economic activity of the entity."

This update provides an overview of the new reporting requirement as it applies to US investment managers.

TIC SLT report requirements

TIC SLT provides a monthly snapshot from US-resident "Required Reporters" (as discussed below) of the fair value of a Required Reporter's aggregate holdings of foreign securities (holdings) and the fair value of a Required Reporter's issuances of securities that are held by foreign residents (issuances). The reporting entity must list the fair value of such holdings and issuances categorized separately by (1) type of holding (e.g., bonds, or equity securities) and (2) the country (a) where the foreign holding's issuer is organized or (b) in which the foreign holder of an issuance is organized or domiciled. The Required Reporter must also summarize all reportable holdings and issuances in certain broader categories such as type of issuer.

The proposed TIC SLT Instructions provide specific guidance for investment managers on how to report US funds' foreign holdings and ownership of fund issuances by foreign residents. However, investment managers will need to consider a number of complicated issues in assessing their reporting requirements under TIC SLT, such as consolidating aggregate positions on a complex-wide basis and among their affiliates, including proprietary assets of

affiliates that are not asset managers (e.g., banks), and identifying exactly which holdings are reportable on TIC SLT. Many of these issues are not comprehensively addressed or even identified in the Proposed Instructions. As a result, investment managers should allocate sufficient time to consider unanticipated questions as they prepare for the first reporting deadline, which may be as early as July 25, 2011.

Required Reporters on TIC SLT include

- *US-Resident Investors* – A US-resident end-investor that invests for its own account or on behalf of others in foreign securities that are held directly by the end-investor. An investment manager must report these types of holdings by its funds and other clients on the investment manager's TIC SLT unless it finds that another Required Reporter, most likely a US custodian of its asset management clients, will report these holdings. While a Required Reporter would include a manager of a US mutual fund that holds foreign securities, others could include, for example, a manager of a US feeder fund that owns interests in an offshore master fund.
- *US-Resident Issuers* – A US resident that issues a security in a foreign market where the security is held directly by a foreign resident. Such a Required Reporter could include, for example, a manager of a US mutual fund that sells its shares to foreign investors.
- *US Custodian for US Residents* – A US-resident custodian that holds foreign securities for the account of US residents (in which case the US-resident end-investors need not file a TIC SLT report for those foreign securities).
- *US Custodian for Foreign Residents* – A US-resident custodian or a US-resident central securities depository that holds US securities on behalf of a foreign resident.

Reportable securities on TLC SLT

Reportable Securities on TIC SLT reports capture data relating to "reportable long-term portfolio securities." Reportable long-term equity securities are "long-term" securities if they have an original maturity of more than one year or no contractual maturity, such as common and preferred stock, among others. Reportable securities are treated as follows:

- *Foreign Securities held by US Residents* – Foreign securities include most securities (equity and debt) issued by entities established under the laws of a foreign country and all securities issued by international and regional organizations (even if these organizations are located in the United States).
- *US Securities held by Foreign Residents* – Securities issued by US residents and owned by foreign residents. A security is deemed to be held by a foreign resident if the holder of record is not a resident of the United States according to the issuer's records.

- *Excluded Securities* – Certain securities are specifically excluded from reporting on TIC SLT, including:
 - short-term securities with an original maturity of one calendar year or less;
 - CDs;
 - bankers' acceptances and trade acceptances;
 - derivative contracts as defined under the Financial Accounting Standards Board's Accounting Standards Codification (ASC) 815;
 - loans and loan participation certificates;
 - letters of credit;
 - precious metals and currencies held in the Required Reporters' vaults for foreign residents;
 - bank deposits;
 - annuities, including variable rate annuities; and
 - securities taken as collateral or received in repurchase/resale agreements and securities lending arrangements.

"Direct investments" (as opposed to "portfolio investments") must be reported on a different reporting system administered by the US Department of Commerce and its Bureau of Economic Analysis (BEA). These direct investments include US-resident ownership of ten percent or more in a foreign company and vice versa, and most positions and transactions with a company with which the investor is in a direct investment relationship. This complex concept will undoubtedly raise interpretive questions (for example, some will question how it applies in the context of the master-feeder arrangements discussed in the Proposed TIC SLT Instructions, as feeders often hold more than 10 percent of a master fund).

Reporting level and consolidation

A Required Reporter must file a single report of the reportable holdings and issuances of all US-resident parts of its own organization (including funds managed). The reporting entity (in theory) is the top US-resident entity within its organization. A reporting entity only need file a TIC SLT report if the consolidated total value of all reportable holdings and issuances across its organization is equal to or exceeds \$1bn (the "Exemption Level") on the last business day of

the reporting month ("Reporting Day"). The consolidated total includes reportable holdings held by all US-resident parts of the reporting entity for their respective accounts and for customers and reportable issuances for all US-resident parts of the reporting entity and "investment companies, trusts, and other legal entities created by the reporting entity."

The consolidated total should be calculated based on the fair value of securities as of the Reporting Day in accordance with ASC 820 using the spot exchange rate as of the close of business on that day.

These broad consolidation rules could capture a large number of US investment managers directly or through the activities of affiliates.

Reporting schedule

The Reporting Days are currently scheduled to be June 30, September 30, and December 30 for 2011 and the last business day of each month thereafter. Once the consolidated total of reportable holdings and issuances is equal to or greater than the Exemption Level on a Reporting Day, a Required Reporter must submit a TIC SLT report for that Reporting Day by the 23rd calendar day of the following month ("Due Date") (or the next business day of that month if the Due Date falls on a weekend or holiday) to the Federal Reserve Bank of New York electronically or via post or fax. Once a Required Reporter has had to submit a TIC SLT report during a year, the entity must submit a report for each remaining month in that calendar year regardless of whether the entity still has consolidated total reportable holdings and issuances equal to or in excess of the Exemption Level.

Penalties for failure to file

The TIC SLT 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 of between \$2,500 and \$25,000. Any person that willfully fails to file a required report may be subject to criminal prosecution, up to a \$10,000 fine and imprisonment for up to one year. In addition, the requirement subjects to the same penalties, officers, directors, employees and agents of any entity with filing obligations.

Conclusion

US investment managers (and notably fund managers) will need to consider their obligations under the TIC SLT reporting requirements. Investment managers should consider whether they or their custodians are fulfilling the new reporting obligations regarding their holdings and issuances. In addition, in connection with assessing their new reporting obligations under TIC SLT, investment managers would be prudent to consider whether they are fulfilling their reporting obligations under the other components of the TIC reporting system and other related Treasury, Fed and BEA reporting regimes.

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