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Foreign Holdings and Transactions with Foreign Persons: Reporting Responsibilities for US Investment Managers and Other Financial Institutions

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Recent changes to the scope of the Treasury International Capital (TIC) B Forms have drawn attention to the reporting obligations of US investment managers within the TIC Form and related reporting systems. TIC reports are used by the US Department of the Treasury (Treasury), the Board of Governors of the Federal Reserve System (Fed), the Federal Reserve Banks, and the US Department of Commerce to collect macroeconomic data for a variety of purposes. The Federal Reserve Bank of New York (the FRBNY) administers collection of the forms on behalf of Treasury. As investment managers take strides to understand the extent to which the changes to the TIC B Forms may require them to file one or more of the forms, they should be mindful of the larger universe of TIC reporting, and should take a holistic approach to identifying the full scope of their TIC reporting obligations. Such an approach reduces time and expense; accounts for the interrelatedness of certain TIC Forms; and also anticipates the possibility that the submission of one TIC filing may prompt the government to ask why the reporter has not been filing other Forms.

This article provides an overview of the TIC reporting requirements, which are further described

below, as they apply to investment managers and discusses the implications to investment managers and other financial institutions that the authors have encountered in practice. The goal of this article is to help investment managers and other financial institutions to identify the reporting requirements applicable to them and to begin to develop a compliance system.

I. Background

Two distinct reporting systems can apply to investment managers:¹

1. The Treasury International Capital (TIC) Reporting System was established in 1934 to gather timely and reliable information 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. 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.² All

entities that are 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 were established in 1973 to provide information on activities affecting 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. Treasury and the Fed use this information to assess and monitor the foreign exchange spot, forward, futures, and options markets.³ Large investment managers that invest their clients' assets in foreign exchange contracts can be required to file FC reports.

Each of the TIC⁴ and FC⁵ reports are authorized and required by an Act of Congress. There is civil and criminal liability for failure to file any required report. 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 is subject to a \$10,000 fine and imprisonment for up to one year.⁶ In addition, the filing requirements subject officers, directors, employees and agents of any entity with filing obligations to the same penalties.

II. General Principles

In our experience, certain issues – such as when to consolidate the reports of various entities (for example, affiliates, clients, etc.) and which entities' data is within scope—arise frequently and are the cause of much confusion. In this section, we discuss some of these issues and the general principles behind resolving them. Getting a handle on these general principles will facilitate conducting an assessment of any potential reporting obligation.

Consolidation & Aggregation

As a general principle, with some exceptions, the FRBNY seeks to have reportable data consolidated

into as few reports as possible. Indeed, historically, the FRBNY has focused its attention primarily on large custodians and other financial intermediaries (such as broker-dealers), which were believed to have access to the vast majority of reportable data. In recent years, the FRBNY has increasingly focused on asset managers and certain other non-bank financial institutions, which they have identified as holding data that would escape an analysis that exclusively targets banks and similar large financial institutions. Even with the increased interest in asset managers, however, the FRBNY continues to favor data being reported on a consolidated basis, by the largest relevant upstream entity, where applicable. The instructions to the various forms typically instruct reporters to consolidate on the basis as is described in generally accepted accounting principles (GAAP). Understanding the forms' consolidation principles can assist asset managers in determining whether they have a reporting obligation, and has the potential to mitigate costs in instances where an upstream entity (such as a custodian bank), and not the asset manager, has the reporting obligation.

For investment managers, the FRBNY's approach to consolidation has three major implications. First, investment managers with US subsidiaries, or which are themselves a part of a larger US enterprise, should generally consolidate their reportable data with that of the larger organization (though, as will be discussed below, there are exceptions in the case of certain types of affiliated entities when it comes to certain of the forms), with the largest parent entity reporting on behalf of its subsidiaries and, in some cases, affiliates. Second, investment managers generally should consolidate the reportable data of all of their US clients. Third, data on assets held by custodians or transactions effected by intermediaries should generally be reported by the custodian or intermediary (for example, banks and broker-dealers), rather than by the investment manager.

As noted above, while the general rule is to consolidate the various parts of an organization into a single TIC report, the instructions for some forms

provide that certain types of businesses are not consolidated with other parts of their organization that are not the same type of entity. The B Forms, C Forms, and Form S, for example, provide that reporters should consolidate all the US-resident parts of their organizations, except (i) brokers and dealers, (ii) depository institutions, and (iii) insurance underwriting entities. These entities should file separate reports for their US-resident offices and subsidiaries. While this approach may have the effect of compounding an entity's reporting requirement, since the relevant reporting threshold is considered independently for each form filed, it can also have the effect of eliminating the need to report on behalf of certain business units that do not, on their own, exceed the reporting threshold. In any event, this approach also means that careful analysis can be necessary to identify potential reporters within a large financial group.

Determining Domicile

A common source of confusion among investment managers trying to understand their reporting obligations is determining which of their affiliates, subsidiaries, clients, counterparties, and investors are in scope, and which are not. Investment managers may manage funds located overseas, as in the case of an offshore feeder fund to a US master fund. Similarly, a US investment manager may have affiliates located overseas that manage US funds. As a general matter, the forms seek data from "US residents."⁷ However, the definitions of "US resident" (and "foreign resident") provided by the instructions to the various forms differ slightly, and the FC forms provide no definition. Some forms, such as the TIC B Forms, emphasize an entity's location in determining its residency. Others, such as TIC Form D, look to where an entity was legally established (though

Table 1—Overview of Reports⁸

Reporting System/Forms	Core Coverage	Potential Reporters
TIC B Forms	Snapshot of cross-border claims and liabilities and holdings of short-term securities	Financial institutions, including non-bank financial institutions, such as investment managers
TIC C Forms	Snapshot of financial or commercial claims on, or liabilities to, foreign persons	Excludes financial institutions, such as 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)
TIC Forms SHC & SHCA	Snapshot report of US residents' holdings of foreign securities	US-resident entities (includes investment managers)
TIC Forms SHL & SHLA	Snapshot report of foreign residents' holdings of US securities	US-resident entities (includes investment managers)
TIC Form SLT	Snapshot of US holdings of foreign long-term securities and foreign holdings of US long-term securities.	US-resident entities (includes investment managers)
FC Forms	Snapshot of foreign exchange contracts and foreign currency liabilities	US resident entities (includes investment managers)

these forms generally consider branches, subsidiaries and affiliates of foreign entities located in the United States to be US residents). While an investment manager's foreign-resident funds or affiliates may be involved in a reportable transaction (as, for example, in the case of an offshore feeder fund that holds shares in an onshore master fund), only US residents qualify as reporters. Therefore, all transactions or positions should be viewed only from the perspective of the US-resident counterparty.

III. Overview

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

IV. TIC Forms

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. 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 Forms BC, BL-1, BL-2, BQ-1, BQ-2, and BQ-3 (collectively, the TIC B Forms) require all

US-resident financial institutions (including, as of January 2014, asset managers) to provide a periodic snapshot of short-term securities (securities with a maturity of one year or less) and claims on and liabilities to foreign residents.⁹ All such US persons with \$50 million in cross-border claims or liabilities (or \$25 million in claims or liabilities in an individual country) are required to report. Forms BC, BL-1, and BL-2 are monthly reports, while Forms BQ-1, BQ-2, and BQ-3 are quarterly reports. The TIC B Forms distinguish between, on the one hand, the financial institution (such as an investment manager or bank), and, on the other hand, its US "customers," which, for purposes of the TIC B Forms, includes, among others, the US funds that an investment manager manages. Thus, for example, an investment manager would report its own reportable data on Forms BC and BL-1, and would report the data of its clients on Forms BL-2 and BQ-1. Reporters should consolidate the reportable data for all their US offices and subsidiaries for reporting proprietary positions, and should consolidate the data of all their US funds on the applicable forms. It should be noted that not all US-resident affiliates and subsidiaries should be consolidated on a single report for purposes of the TIC B Forms. Certain types of financial institutions, including banks, broker-dealers and insurance underwriters, must file their own TIC B reports, though they may consolidate with other entities of the same type within the organization (that is, all broker-dealer entities within the organization may file a single TIC B report).

It is important to note that the TIC B Forms generally do not exclude cross-border positions between affiliated entities. Thus, common reportable claims in the asset management context may include the management fees owed to a US investment manager by an offshore fund it manages or payments owed by US funds to the manager's foreign offices that have accrued, but not yet been paid as of the applicable spot reporting date. Other examples of potential reportable data on the TIC B Forms include bank deposits placed overseas by US funds or investment

managers; a US fund's cash collateral posted with a foreign custodian or counterparty pursuant to a derivatives contract; or a US fund's holdings of short-term securities issued by a foreign issuer.

TIC C Forms

Forms CQ-1 and CQ-2 (collectively, the TIC C Forms) are quarterly reports that capture broadly the same data as the TIC B Forms. Historically, non-bank financial institutions, such as investment managers, reported their cross-border claims and liabilities on the TIC C Forms (along with non-financial reporters). Beginning in January 2014, however, such non-bank financial institutions were removed from reporting on the TIC C Forms, and now instead report such data on the TIC B Forms, as noted above. As a result of these changes, investment managers generally do not need to consider the TIC C Forms. However, if the investment manager is part of a large organization that includes both financial and non-financial entities, there may be TIC C reporters somewhere in their larger organization, and the compliance effort may thus need to encompass the TIC C Forms.

TIC D Form

Form D requires major US-resident participants in derivatives markets (including investment managers, non-bank holding companies, and broker-dealers) to provide, on a quarterly basis, snapshot information regarding cross-border derivatives contracts.¹⁰ 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 \$400 billion at the end of the calendar quarter being reported. This is a very large amount, so, in the experience of the authors, asset managers are rarely TIC D filers.

In addition, while an investment manager must file Form D if the aggregate notional value of its (or

its clients') cross-border derivatives contracts exceeds the \$400 billion notional reporting threshold, it is not required to report the cross-border derivatives contracts of its clients if the investment manager was not acting as counterparty or transacting party (for example, broker-dealers) in entering a derivatives contract. Thus, 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.¹¹

TIC S Forms

The TIC Forms S, SHC, SHCA, SHL, SHLA, and SLT (collectively, the TIC S Forms) 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.¹²

Form S requires US-resident entities to file monthly reports of the aggregate purchases and sales of long-term US and foreign securities (including equities and fixed income securities with an original maturity of more than one year) between US and foreign residents. In the investment management context, this includes both the portfolio securities issued by foreign issuers that are purchased and sold by funds and interests/shares that the funds issue to or redeem from foreign investors. The reporting threshold is \$50 million in total long-term securities transactions during the reporting month. Critically, however, Form S is filed by the entity that *actually executes* a long-term security order. Thus, in situations in which a US broker-dealer executes the trade, the broker-dealer, and not the investment manager, would report the data on TIC S. This makes it unlikely that an investment manager would be required to report its portfolio investments, unless the investment manager places trades directly with foreign broker-dealers.

In practice, there are three situations that commonly may impose a reporting obligation on investment managers. First, in the case of a US

master fund and a foreign feeder fund (or the opposite arrangement), transactions in ownership interests between the onshore and offshore entities may constitute reportable transactions.¹³ Second, a US fund may issue securities to foreign investors that are either sold directly to those investors, or are sold through a non-US broker-dealer. Third, an investment manager uses foreign broker-dealers to place trades on behalf of its US clients. In each of these scenarios, no US TIC reporter other than the investment manager would be aware of the transactions. It would therefore fall to the investment manager to report them. In our experience, certain investment managers that previously concluded that they did not have a TIC S reporting obligation realized after review that they have to file TIC S forms after all.

Form SLT, which was introduced in 2011, requires monthly snapshot reporting of US residents' holdings of foreign securities and foreign residents' holdings of US securities. TIC SLT only captures holdings of long-term securities, such as equities or bonds having an initial maturity of more than one year; holdings of short-term securities (as discussed above) should be reported on the relevant TIC B Forms. For US investment managers, the implications of TIC Form SLT are two-fold: their US funds may be both (i) holders of foreign securities and (ii) issuers of US securities to non-US investors. Since a US fund's holdings of foreign securities will typically be held by a US custodian, the reporting obligation for such holdings will ordinarily fall on the US custodian. However, if the foreign securities are held by a non-US custodian or no custodian at all, then the fund's US investment manager may be responsible for reporting the securities. With respect to the fund as an issuer, it may be less likely that foreign investors will hold their funds' shares with a US custodian. Accordingly, it may frequently fall on the US investment manager to report the holdings of the securities it issues by non-US investors. Investment managers should consolidate their holdings with those of their US clients both for reporting purposes and for determining whether the reporting threshold

has been exceeded. The reporting threshold for Form SLT is \$1 billion.

Forms SHC and SHCA require US-resident custodians and end-investors (including investment funds) to file snapshot reports of holdings of foreign securities on a security-by-security basis. Form SHC is a benchmark survey and is filed approximately once every five years, with the most recent filing having occurred in 2012. Form SHCA is filed annually by the largest SHC filers (as determined based on prior SHC and SLT filings). Reportable securities include both short-term and long-term securities (including equities, short-term debt securities, long-term debt securities, and asset-backed securities).

Unlike other TIC Forms discussed above, the reporting obligations for filing Forms SHC and SHCA may be triggered even where a potential reporter does not exceed a reporting threshold. US-resident custodians and end-investors must file Form SHC if either (i) the total fair value of foreign securities they hold either directly, with a foreign-resident custodian, or with a US or foreign-resident central securities depository is \$100 million or greater; or (ii) they are notified by the FRBNY that they are required to file. Filing of Form SHCA is required only where the reporter has been contacted by the FRBNY. It should be noted however, that with respect to both Forms SHA and SHCA, entities owning or holding in custody less than \$100 million in foreign securities, even if contacted by the FRBNY, are exempt from filing the more onerous portions of the forms.

Forms SHL and SHLA are similar to Forms SHC and SHCA, but capture holdings of US securities by non-US residents. This data is typically reported either by US-resident custodians who hold US securities on behalf of non-US residents or by US-resident issuers whose shares are owned by non-US residents and not held by a US custodian. Form SHL is a benchmark survey and is filed approximately once every five years. The next TIC SHL survey is scheduled to be collected in 2014,

with a filing deadline of August 29, 2014. Form SHLA is filed annually by the largest SHC filers (as determined based on prior SHL and SLT filings). Reportable securities include both short-term and long-term securities (including equities, short-term debt securities, long-term debt securities, and asset-backed securities).

As with Forms SHC and SHCA, filing of Form SHL is required either if the reporter has exceeded the threshold (the total value of reportable US securities owned by foreign residents is \$100 million or more), or it has been contacted by the FRBNY, while filing of Form SHLA is required only where the reporter has been contacted by the FRBNY. In addition, such entities owning or holding in custody less than \$100 million in foreign securities, even if contacted by the FRBNY, are exempt from filing the more onerous portions of the forms.

V. Treasury Foreign Currency Forms

Forms FC-1, FC-2, and FC-3 (collectively, the FC forms) require reporting of a snapshot of US residents' (and their US or foreign subsidiaries') foreign exchange contracts and foreign currency assets and liabilities. These reports are filed on a weekly, monthly and quarterly basis, respectively. The forms require reporting of foreign exchange spot, forward, and futures purchased and sold, as well as net options positions. In addition, Forms FC-2 and FC-3 require reporting of foreign currency-denominated assets and liabilities. Thresholds are calculated by adding the amount of foreign exchange spot contracts bought and sold, foreign exchange forward contracts bought and sold, foreign exchange futures bought and sold, plus one half of the notional amount of foreign exchange options (that is, foreign exchange options bought and sold divided by two). The threshold is met if the total foreign exchange contracts (measured in US dollar equivalents) on the last business day of any calendar quarter during the previous year exceeds the relevant threshold (calculated using

then-prevailing exchange rates). The relevant thresholds are \$50 billion for FC-1 and FC-2, and \$5 billion for FC-3. In addition, for each of the FC Forms, an addendum capturing details of net options positions must also be supplied if the aggregate notional principal amount of options purchased and sold by the reporter exceeds \$500 million in equivalent specified currencies.

Asset managers should note that the consolidation and aggregation principles that apply generally to the TIC Forms differ in the case of the FC Forms in two important respects. First, for purposes of the FC Forms, asset managers are not required to consolidate their own proprietary positions and holdings with those of their clients. Second, clients' holdings and positions should be considered independently of one another, and should not be aggregated for reporting and threshold determination purposes. However, investment managers should note that, unlike certain TIC forms, reporting is required even if client assets are held by a US custodian.

VI. 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 that, given the diverse data collected by the forms, often requires input from a wide range of sources within an organization, including compliance, accounting, and finance personnel. Establishing a working group comprised of members of the relevant departments and business units within an organization is often an effective way of assessing the scope of potential reporting obligations. Once the reporting system is in place, it usually requires little follow-up involvement.

This article updates an article published in the September 2008 issue of *The Investment Lawyer*. Some of the content originally appeared in that article. **Julien Bourgeois** is a partner, and **Philip Hinkle** and **Matthew Barsamian** are associates, in the Financial Services Group of Dechert LLP.

NOTES

¹ A third set of forms administered by the US Department of Commerce and its Bureau of Economic Analysis (the BEA Forms) capture data concerning “direct investments” (as opposed to the “portfolio investments” with which the TIC and FC Forms are primarily concerned). These direct investments include US-resident ownership of 10% 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, and often subtle, distinction frequently raises interpretive questions concerning whether certain data should be reported on TIC Forms, BEA Forms, or (in rare circumstances) both.

² See Instructions for the Treasury International Capital (TIC) Form B Reports, September 2013; Instructions for the Quarterly Treasury International Capital (TIC) Form C Reports, September 2013; Instructions for the Quarterly Treasury International Capital (TIC) Form D Report, March 2012; Instructions for the Monthly Treasury International Capital (TIC) Form S and Memorandum, June 2011; Report of US Ownership of Foreign Securities, Including Selected Money Market Instruments (SHCA), November 2013 (instructions also apply to Form SHC); Foreign-Residents’ Holdings of US Securities, Including Selected Money Market Instruments (SHL(A)), March 2013; and Instructions for the Monthly Treasury International Capital (TIC) Form SLT, June 2011. Current reports of the TIC data are posted on the US Treasury web site, www.treas.gov/tic.

³ See FC-1, -2 and -3, Background, October 4, 1999.

⁴ See 22 U.S.C. 286f; 22 U.S.C. 3103; E.O. 10033, as amended.

⁵ See 31 U.S.C. 128.1(a); see also Title II of Public Law 93-110; FC-1, -2, and -3, Background, October 4, 1999.

⁶ See 22 U.S.C. § 3105 (penalties related to TIC Forms); 31 C.F.R. § 128.4 (penalties related to FC forms).

⁷ TIC Form SLT refers to “US persons,” rather than “US residents.”

⁸ Treasury, the Board of Governors of the Federal Reserve System and the US Department of Commerce administer other reporting systems, which, in the authors’ experience, generally would not apply to investment managers.

⁹ For a more in-depth overview of the TIC B Forms and the recent changes to them, see *DechertOnPoint* “TIC B Forms Are Amended to Explicitly Cover US Investment Managers,” available at <http://sites.edechert.com/10/2077/december-2013/tic-b-forms-are-amended-to-explicitly-cover-u.s.-investment-managers.asp>.

¹⁰ 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.

¹¹ For further information regarding TIC Form D, see *DechertOnPoint* “Changes to TIC Form D Highlight US Investment Managers’ Potential Reporting Obligations Regarding Cross-Border Derivatives Positions,” available at http://www.dechert.com/files/Publication/53e5d5b9-75a7-491e-bc9d-5d0fb62ac06a/Presentation/PublicationAttachment/082d4f07-f9b4-4789-ab1f-753a9517c7f2/FS_12_06-12_Changes_to_TIC.pdf.

¹² For further information regarding TIC Forms SLT and SHC, see *DechertOnPoint* “Treasury Is Adopting New Reporting Requirements Regarding Cross-Border Holdings Applicable to US Investment Managers,” available at <http://www.dechert.com/files/Publication/a47d14ea-0909-490a-b15d-c8720d3fffb16/Presentation/>

PublicationAttachment/4748523e-b956-4bc0-a5f2-e2a1b6eb4f09/FS_8_05-11_Treasury_Adopts_Requirement(update).pdf.

- ¹³ Note that the master-feeder arrangement constitutes an exception to the general rule that direct invest-

ments are excluded from TIC Form reporting. Thus, notwithstanding the fact that in the typical master-feeder relationship, one entity controls the other, transactions in securities between such entities are within the scope of TIC S.

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