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By Electronic Delivery

17 December 2015

Gd Ingemar Hansson
Skatteverket
S -171 94 Solna
SWEDEN

RE: *U.S. Mutual Funds Qualify for Withholding Tax Exemption*

Dear Director-General Hansson:

The ICI Global,[1] on behalf of the U.S. investment fund industry, renews our request that the Swedish Tax Agency (STA) announce promptly that U.S. open-end investment companies ("U.S. funds") are exempt from Swedish withholding tax.[2] This exemption should be provided for Swedish taxes withheld both prior to 2012 and since Sweden's withholding tax rules were amended effective 1 January 2012.

Since we first made this request, in the enclosed letter dated 19 September 2013, the Swedish courts have held that U.S. funds are entitled to the exemption provided previously only to Swedish funds.[3]

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[1] The international arm of the Investment Company Institute, ICI Global serves a fund membership that includes regulated funds publicly offered to investors in jurisdictions worldwide, with combined assets of US$19.4 trillion. ICI Global seeks to advance the common interests and promote public understanding of regulated investment funds, their managers, and investors. Its policy agenda focuses on issues of significance to funds in the areas of financial stability, cross-border regulation, market structure, and pension provision. ICI Global has offices in London, Hong Kong, and Washington, DC.

[2] The funds covered by our request issue redeemable shares and hence have variable capital. These funds register with the U.S. Securities and Exchange Commission (SEC) as registered investment companies (RICs) and are regulated as such under the Investment Company Act of 1940 (the 1940 Act). 15 United States Code §§ 80a-1 *et seq*. *See also* www.sec.gov.

[3] *See e.g.,* the judgments issued by the Administrative Court of Appeal in Sundsvall on 15 December 2014 in *Skatteverket v. Dodge & Cox Global Stock Fund* (Case no. 862-13) and *Skatteverket v. Dodge & Cox International Stock Fund* (Case no. 863-868-13).

Moreover, we understand, the STA has begun issuing tax-exemption rulings to individual U.S. funds. Hence, the comparability of U.S. funds and Swedish funds for Article 63 TFEU purposes seems firmly established.

The most expeditious and least burdensome manner to resolve this issue would be for the STA to announce publicly that all U.S. funds are exempt from tax; comparable guidance was announced by the STA on 23 May 2012 for "all undertakings that are authorised in accordance with the UCITS IV Directive."[4] The published guidance we suggest would state simply that a U.S. fund (as defined in footnote 2, above) is exempt from Swedish withholding tax under section 4, paragraph 9 of the Swedish Withholding Tax Act; this exemption, as you know, is provided to "foreign collective investment undertakings" as defined in Chapter 1, section 1, first paragraph, subsection 9 of the Swedish Investment Funds Act (SIFA).

U.S. funds, as discussed in detail in the ICI's prior submissions (also enclosed), meet all of Sweden's requirements for "foreign collective investment undertaking" status.[5] Specifically,

- U.S. funds are authorized in the U.S. to conduct operations;
- The purpose of each fund is to make collective investments in transferable securities using capital raised from the public;
- Each fund applies the principle of risk spreading; and
- The units of each fund are redeemable at the request of the holders.

A U.S. fund easily could certify its status as an open-end investment company regulated by the SEC; proof of this status could be provided to the STA via a link to the page on the SEC's public website on which the fund's relevant required filings are disclosed.[6]

If the STA insists that each eligible fund nevertheless should apply for a private ruling exempting it from tax, the STA should provide clear guidance regarding how such a ruling should be requested. In particular, U.S. mutual funds would need the contact details (*e.g.,* name, title, e-mail address, phone number) for the person(s) to whom requests should be directed. Absent this guidance, ruling requests may be received by multiple STA officials whose contact details are known by the industry.

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[4] *See,* Skatteverkets ställningstaganden 131 128777-12/111: "What is meant by foreign investment funds?"

[5] Indeed, the Administrative Court in Falun in the *Dodge & Cox* cases (according to an unofficial translation of the judgment) cited the enclosed ICI memorandum as providing "compelling support for the position that the fund in the relevant respect is comparable to a Swedish investment fund." *See, e.g.,* Judgment of the Administrative Court in Falun of 24 January 2013, *Dodge & Cox Global Stock Fund v. Skatteverket* (case no. 1932-11).

[6] http://www.sec.gov/edgar/searchedgar/mutualsearch.html

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On behalf of the U.S. fund industry, we appreciate your continued attention to this important matter. Please feel free to contact me (at lawson@ici.org or 001-202-326-5832) if I can provide you with any additional information.

Sincerely,

Keith Lawson
Deputy General Counsel – Tax Law

Enclosures

cc: Ingemar Rönnäng
Agneta Schalling
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September 19, 2013

Gd Ingemar Hansson
Skatteverket
S -171 94 Solna
SWEDEN

RE: *U.S. Mutual Funds Qualify for Withholding Tax Exemption*

Dear Director-General Hansson:

The Investment Company Institute ("ICI"),[1] on behalf of the U.S. fund industry, urges the Swedish Tax Agency to announce promptly that U.S. funds are entitled to a withholding tax exemption. This exemption should be provided for Swedish taxes withheld both prior to 2012 and since Sweden's withholding tax rules were amended effective 1 January 2012.

The arguments advanced by the Swedish Tax Agency to reject the claims filed by our members for all years would retain the preferential treatment for Swedish funds vis-à-vis U.S. funds. The Court of Justice of the European Union ("EU-Court") in *Santander*[2] expressly rejected these arguments because they impermissibly restrict the free movement of capital. One Swedish court already has agreed that *Santander* compels the relief we request.[3]

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[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds ("ETFs"), and unit investment trusts ("UITs"). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $15.4 trillion and serve more than 90 million shareholders.

[2] Case C-338/11 – C-347/11 *Santander Asset Management SGIIC SA and others* [2012] ECR I-0000. The English-language version of the Court's opinion is found at:
http://curia.europa.eu/juris/document/document.jsf?text=&docid=122645&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=944041

[3] *See* Judgment of the Administrative Court in Falun of 24 January 2013, case no. 1933—1938-11. The judgment has been appealed by the Swedish Tax Agency (case no. 863—868-13 in the Swedish Court of Appeal).

The free movement of capital provision of Article 63 of the Treaty on the Functioning of the European Union ("TFEU"),[4] according to the EU-Court in *Santander*, must be applied in two contexts. Specifically, the EU-Court observed, the "established case-law" has made clear that Article 63 prohibits both measures that "discourage non-residents from making investments in a Member State" as well as those that "discourage that Member State's residents from doing so in other States."[5]

The French law in *Santander* and the Swedish laws – both the old law invalidated by the lower Swedish court and the new law enacted in 2012 – are indistinguishable from an Article 63 perspective. Both laws provide for a "difference in the tax treatment of dividends according to the [funds'] place of residence."[6] The French law was struck down by the EU-Court because it "may discourage, on the one hand, non-resident funds from investing in companies established in France and, on the other, investors resident in France from acquiring shares in non-resident funds."[7] The Swedish laws (both old and new) are equally invalid under Article 63.

The Swedish Tax Agency – both in its correspondence with the ICI and in its court filings – continues to disregard one of Article 63's express purposes: to allow Swedish companies to receive capital freely from both Swedish funds and non-Swedish funds. We submit that taxing U.S. funds less favorably than Swedish funds when the funds make comparable investments in Swedish companies violates Article 63.

More specifically, the Swedish Tax Agency has sought to identify differences, however small, between the regulatory regimes applicable to Swedish and U.S. funds. There are some small differences, of course, between how U.S. funds and Swedish funds are regulated. Their governing statutes are not precisely identical.

The free movement of capital provision, however, does not require that U.S. funds and Swedish funds be identical. The EU-Court stated that the legal standard is whether two situations are "objectively comparable."[8]

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[4] Specifically, Article 63(1) provides that "[w]ithin the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited."

[5] *Santander,* Paragraph 15.

[6] *Santander,* Paragraph 17.

[7] *Santander,* Paragraph 17.

[8] *Santander,* Paragraphs 7, 8, 23. Were identical treatment required, the non-Swedish funds for which Sweden already has provided relief would not be so entitled under Article 63.

Indeed, by treating all European UCITS (whether Swedish or not) as comparable, the Swedish Tax Agency has acknowledged that the regulatory regimes need not be identical. Specifically, while the governing European statute (the UCITS Directive)[9] applies equally to all EU Member State funds, national implementation considerations have resulted in inevitable regulatory differences across Europe.

The U.S. funds for which the ICI has sought relief, and those that have prevailed in the Swedish courts, are funds that are organized and regulated under the Investment Company Act of 1940 (the 1940 Act).[10] 1940-Act-registered funds are the *only* type of fund available in the U.S. through which individual investors may acquire diversified interests in securities.[11]

These U.S. funds are comparable to Swedish UCITS – which are the vehicle through which Swedish individual investors may acquire diversified interests in securities. In each case, these funds (as we say in the U.S.) are "the only game in town." To focus on matters such as the minimum number of securities that one fund or the other must hold under the applicable securities law is to miss the point of Article 63; for Swedish companies to have unfettered access to *comparable* sources of capital under Article 63, the funds available to provide that capital must be comparable – *not* identical. Because U.S. 1940-Act funds and Swedish UCITS are securities investments regulated for sale to individual investors, they meet the comparability requirement. The EU-Court reached this same result, with respect to a U.S. 1940-Act fund and French UCITS, in *Santander*.

In conclusion, we respectfully request that the Swedish Tax Agency acknowledge promptly that U.S. funds regulated under the U.S. Investment Company Act of 1940 are entitled to a withholding tax exemption. The requested acknowledgement has two distinct components.

First, the Sweden Tax Agency should drop its appeal of the lower court decision holding that U.S. funds were denied withholding tax relief in contravention of Article 63. Concurrently, the Swedish Tax Agency should announce that they will refund taxes withheld from all U.S. funds and honor all refund claims filed by U.S. funds for taxes withheld prior to 1 January 2012.

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[9] Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

[10] 15 United States Code §§ 80a-1 *et seq*.

[11] The ICI's previous submissions, dated June 1, 2012 and July 19, 2012 (and, in particular, the 13-page detailed response to Skatteverket's follow-up questions enclosed with the July 19 submission) describe in great detail the extensive regulation to which U.S. funds are subject under the 1940 Act. Both of these submissions and their supplemental memoranda are included as enclosures to this letter.

Second, the Swedish Tax Agency should issue public guidance announcing that U.S. funds regulated under the 1940 Act are entitled to the withholding tax relief provided by section 4, paragraph 9 of the Swedish Withholding Tax Act to "foreign collective investment undertakings" as defined in Chapter 1, section 1, first paragraph, subsection 9 of the Swedish Investment Funds Act ("SIFA").[12] As discussed in detail in the ICI's prior submissions (enclosed), U.S. funds regulated under the 1940 Act meet all of the requirements for "foreign collective investment undertaking" status. Specifically,

- U.S. funds are authorized in the U.S. to conduct operations;
- The purpose of each fund is to make collective investments in transferable securities using capital raised from the public;
- Each fund applies the principle of risk spreading; and
- The units of each fund are redeemable at the request of the holders.

The acknowledgement we request will ensure that U.S. funds are not discriminated against vis-à-vis Swedish funds in violation of Article 63 and also that Swedish operating companies have the unimpaired access to capital provided by Article 63. Because U.S. funds regulated under the 1940 Act and Swedish investment funds are "objectively comparable" – which is the only standard applicable under Article 63 – this acknowledgement should be announced promptly.

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On behalf of the U.S. fund industry, we appreciate your continued attention to this important matter. Please feel free to contact me (at lawson@ici.org or 001-202-326-5832) if I can provide you with any additional information.

Sincerely,

Keith Lawson
Senior Counsel – Tax Law

Enclosures

cc: Ingemar Ronnang
Agneta Schalling
Hedvig Kärnekull

[12] http://www.regeringen.se/content/1/c6/17/55/29/dacaae9d.pdf.

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June 1, 2012

Gd Ingemar Hansson
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SWEDEN

RE: *U.S. Mutual Funds (RICs) Should Qualify as Exempt Fund Undertakings*

Dear Director-General Hansson:

The Investment Company Institute ("ICI"),[1] on behalf of the U.S. fund industry, requests confirmation that U.S. mutual funds[2] qualify for the withholding tax exemption provided by Swedish domestic law for dividends paid to "fund undertakings."[3] An announcement by the Swedish Tax Authority that applies to all U.S. mutual funds will reduce substantially the administrative burden on U.S. funds, on their custodians and subcustodians, and on the Swedish Tax Authority. Without such an announcement, every U.S. fund seeking the exemption could be required to file a separate claim and provide sufficient supporting evidence of its qualification as a fund undertaking.

Our request is fully consistent with the recent Swedish Tax Authority announcement that all UCITS funds[4] will receive the "fund undertakings" exemption. Presumably, the guidance provided to UCITS was designed to eliminate the need for each fund to establish separately that it qualifies as a

[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds ("ETFs"), and unit investment trusts ("UITs"). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $13.4 trillion and serve over 90 million shareholders.

[2] A "mutual fund" is an open-end investment company that permits daily purchases and redemptions of its shares at net asset value. Our request, as discussed below, is limited to mutual funds that register under the applicable U.S. securities law – the Investment Company Act of 1940 – as open-end investment companies.

[3] http://www.regeringen.se/content/1/c6/17/55/29/dacaae9d.pdf

[4] A UCITS fund is one that satisfies the requirements of the Fourth Undertakings for Collective Investment in Transferable Securities ("UCITS") Directive ("the UCITS IV Directive").

fund undertaking. U.S. mutual funds, as discussed below (and in the enclosed detailed memorandum), are in all relevant respects equivalent to UCITS funds and should receive the same relief.

Organization and Operation of U.S. Mutual Funds

U.S. mutual funds are required to register as open-end investment companies under the Investment Company Act of 1940 ("the 1940 Act").[5] Mutual funds, pursuant to the 1940 Act, must allow shareholders to redeem their fund shares on a daily basis. Although most U.S. mutual funds are organized for retail investors, some are organized only for institutional investment. Many are combined retail/institutional vehicles, with separate classes of shares for the retail and institutional investors. U.S. mutual funds typically have thousands of shareholders; some have hundreds of thousands of shareholders.

Requirements to Claim "Fund Undertaking" Status

A foreign investment fund that is located in an eligible country[6] will be treated as a fund undertaking and qualify for the domestic at-source exemption if:

- the fund is authorized in its home state;
- the fund is organized to make collective investments in transferable securities with capital raised from the public;
- the fund operates the principle of risk allocation; and
- and fund's units are redeemable on demand of the investor.

The Swedish Tax Authority, as noted above, already has announced that a UCITS fund registered under the UCITS IV Directive will be eligible for the domestic tax exemption provided for dividends. A comparable exception has been provided for a non-UCITS fund that is registered with the Swedish Financial Services Authority ("FSA") for sale in Sweden.

U.S. Mutual Funds Meet the "Fund Undertaking" Requirements

U.S. mutual funds meet each of the four requirements to be treated as a fund undertaking. First, our request is limited to those mutual funds that register under the 1940 Act as open-end

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[5] 15 United States Code §§ 80a-1 *et seq*.

[6] An eligible country is one that (1) is established in the European Economic Area ("EEA"), (2) has a tax treaty with Sweden that includes an exchange of information provision, or (3) has entered into a tax information exchange agreement with Sweden. The U.S. meets the second requirement. Article 26 of the Swedish-U.S. income tax treaty provides for the exchange of tax information. *See also,* http://www.skatteverket.se/download/18.71004e4c133e23bf6db800062000/Double+taxation+agreements.pdf.

investment companies. Pursuant to the 1940 Act, U.S. mutual funds are both authorized by U.S. securities laws and subject to extensive regulatory oversight by the U.S. Securities and Exchange Commission.

Second, all such funds are pooled investment vehicles that hold securities of multiple issuers. Under the U.S. tax laws applicable to mutual funds (found in Subchapter M of the U.S. Internal Revenue Code),[7] a fund cannot qualify for Subchapter M treatment as a regulated investment company ("RIC") unless its portfolio is diversified sufficiently.[8]

Third, the risks of the fund's investments are shared equally by all of the fund's investors. Funds are required every day to calculate a net asset value ("NAV") for its shares. The NAV is calculated by dividing the value of a fund's assets, net of all expenses and other liabilities, by the number of shares outstanding. Every fund investor bears the same per-share risk that the value of the fund's portfolio securities will fall (as each receives the same per-share benefit that the value of the fund's portfolio securities will rise).

Finally, mutual funds are required to redeem an investor's shares upon shareholder demand. This daily redemption feature is one that distinguishes mutual funds from other types of U.S. investment vehicles (such as hedge funds).

It is instructive that the European Court of Justice, in the Santander case,[9] did not distinguish between the eight European UCITS and the two U.S. funds that were claimants in the consolidated test case. The Santander case, as you know, involved the application of Article 63 of the Treaty on the Functioning of the European Union (regarding free movement of capital) to withholding tax imposed by France on dividends paid by French companies to non-French funds (but not to French funds). As the Court effectively recognized, U.S. funds are equivalent to UCITS for all relevant withholding tax purposes. Indeed, the English-language version of the opinion refers to the two U.S. funds as "U.S. UCITS."

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Consequently, we respectfully request that the Swedish Tax Authority issue this guidance to all U.S. mutual funds that register with the SEC under the Investment Company Act of 1940 as open-end investment companies. Such guidance will prevent each U.S. fund investing in Sweden from

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[7] *See* Internal Revenue Code section 851 *et seq.*

[8] *See* Internal Revenue Code section 851(b)(3).

[9] The English-language version of the Court's opinion is found at: http://curia.europa.eu/juris/document/document.jsf?text=&docid=122645&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=944041.

being required to file its own proof of qualification and recover taxes by reclaim, rather than at-source. The administrative savings for U.S. funds, for their custodians, and for the Swedish Tax Authority, support our request. Please feel free to contact me (at lawson@ici.org or 001-202-326-5832) if I can provide you with any additional information.

Sincerely,

Keith Lawson
Senior Counsel – Tax Law

Enclosure

June 1, 2012

U.S. OPEN-END REGISTERED INVESTMENT COMPANIES QUALIFY AS "FUND UNDERTAKINGS" UNDER SWEDISH DOMESTIC LAW

Mutual funds that are organized in the United States as registered investment companies under the Investment Company Act of 1940[1] ("the 1940 Act") meet all four requirements of Swedish law to be treated as "fund undertakings" exempt from withholding tax. These funds in all relevant respects are comparable to funds that satisfy the requirements for treatment as an Undertaking for Collective Investment in Transferable Securities ("UCITS") – which the Swedish Tax Agency already has determined qualify as "fund undertakings." Indeed, this comparability determination also has been made by the European Court of Justice which, in the Santander decision,[2] held that two U.S. funds were comparable to French UCITS for purposes of Article 63 of the Treaty on the Functioning of the European Union (regarding free movement of capital).

The letter accompanying this memorandum explains why U.S. mutual funds qualify as "fund undertakings" under Swedish law. This memorandum supplements the letter by providing additional information regarding U.S. funds. Specifically, the memorandum describes (1) the organization and operation of RICs; (2) the tax treatment provided to RICs and their shareholders; and (3) why RICs are (a) persons, (b) resident in the U.S., and (c) the beneficial owners of their income.

I. The Organization and Operation of RICs

A. Legal Form

Collective investment vehicles ("CIVs") in the United States may be organized, under the laws of the 50 states, as either corporations or business trusts. All U.S. CIVs that qualify for RIC tax treatment under Subchapter M of the Internal Revenue Code ("IRC") are treated for U.S. income tax purposes as corporations.

B. Distribution

RICs may be organized as retail investment vehicles, as institutional investment vehicles, or as combined retail/institutional vehicles (with separate classes of shares for the retail and institutional investors). RICs typically have thousands of shareholders; some RICs have hundreds of thousands of shareholders. Some RIC shareholders hold as nominees for their clients. Nominee accounts include street name accounts set up by brokerage firms, banks, and financial planners for their customers and those set up by so-called "fund supermarkets," which are created by financial services firms to invest

[1] 15 U.S.C. §§ 80a-1 *et seq.*

[2] The English-language version of the Court's opinion is found at: http://curia.europa.eu/juris/document/document.jsf?text=&docid=122645&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=944041.

their clients' assets in other firm's RICs. Because customer identity information is a valuable commercial asset, firms with the customer relationship may utilize the nominee account structure to shield the client's identity from competitors, including RICs and the financial services firms that manage RICs. The nominee account structure, importantly, does not shield client information from the Internal Revenue Service ("IRS").

II. The Tax Treatment of RICs and Their Shareholders

A. U.S. (Domestic) Taxation of RICs and Their Resident Investors

1. *Domestic Taxation of RICs*

A CIV cannot qualify for RIC tax treatment (under Code sections 851 and 852) unless it is taxed as a domestic corporation and meets several tests, including those regarding the sources of its income, the diversification of its assets, and the distribution of its income.

Under the "good income" test,[3] at least 90 percent of a fund's gross income must be derived from certain sources, including dividends, interest, payments with respect to securities loans, and gains from the sale or other disposition of stock, securities, or foreign currencies.

Under the "diversification" test,[4] at least 50 percent of the value of the fund's total net assets must consist of cash, cash items, government securities, securities of other funds, and investments in other securities which, with respect to any one issuer, represent neither more than 5 percent of the assets of the fund nor more than 10 percent of the voting securities of the issuer. Further, no more than 25 percent of the fund's assets may be invested in the securities of any one issuer (other than government securities or the securities of other funds), the securities (other than the securities of other funds) of two or more issuers which the fund controls and are engaged in similar trades or businesses, or the securities of one or more qualified publicly traded partnerships.[5]

Pursuant to the distribution requirement,[6] a RIC must distribute with respect to its taxable year at least 90 percent of its income (other than net capital gain). The remaining 10 percent of ordinary income, and all capital gain, may be retained. All retained income, however, is taxed at regular

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[3] *See* IRC § 851(b)(2).

[4] *See* IRC § 851(b)(3).

[5] Each of these diversification requirements is applied at the close of each quarter of the fund's taxable year.

[6] *See* IRC § 852(a)(1).

corporate tax rates. Because a RIC that incurs corporate tax provides a lower return than one that does not incur such tax, RICs generally attempt to distribute all of their income.

In addition, U.S. tax law imposes an excise tax[7] on any RIC that does not distribute essentially all of its income during the calendar year in which it is earned. To eliminate any excise tax liability, a RIC must distribute by December 31 an amount equal to the sum of: (1) 98 percent of its ordinary income earned during the calendar year; (2) 98 percent of its net capital gain earned during the 12-month period ending on October 31 of the calendar year; and (3) 100 percent of any previously-earned amounts not distributed during the prior calendar year. A tax of 4 percent is imposed on the amount, if any, by which the RIC's required distribution exceeds the amount actually distributed. The excise tax, in effect, acts as an interest charge on undistributed amounts. RICs typically seek to avoid this charge by electing to distribute their income currently.

2. *Domestic Taxation of Resident Investors in RICs*

U.S. individuals and other taxpaying persons investing in RICs are taxed upon: (1) the receipt of RIC distributions (whether received in cash or reinvested in additional RIC shares); and (2) the disposition of RIC shares. A RIC shareholder is taxed on a distribution whether or not the shareholder was invested in the RIC on the date that the income was received by the RIC. In contrast, net operating losses or net capital losses realized by the RIC do not flow through to RIC shareholders; net capital losses are carried forward to the RIC's next taxable year, but net operating losses expire (and are lost).

All RIC distributions are taxed as ordinary dividends (because RICs are corporations for U.S. income tax purposes), unless the tax law expressly permits the character of the income to be retained. For example, the capital gains arising from the sale of RIC portfolio assets held for more than one year (which are taxable at rates below the marginal tax rate) may be paid as "capital gain dividends" eligible for the lower tax rates. In contrast, capital gains arising from the sale of RIC portfolio assets held for one year or less are distributed as ordinary dividends taxed at the investors' marginal tax rates.

Any gain realized by a RIC investor upon the sale of fund shares is taxed as short-term or long-term capital gain depending upon the length of time the fund shares were held.

3. *Domestic Taxation of Non-Resident Investors In RICs*

The U.S. tax treatment of non-U.S. investors in RICs reduces significantly the attractiveness of RICs to non-U.S. investors. In addition, because RICs are almost never registered for sale outside of the United States, RICs generally are owned almost exclusively by U.S. investors.

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[7] *See* IRC § 4982.

There are three significant adverse tax effects of non-U.S. investments in RICs that, in general, limit substantially the attractiveness of RICs for non-U.S. investors. These adverse tax effects are: (1) U.S. taxation of non-U.S. source income; (2) current distributions of income and gain; and (3) resident-country taxation at "regular" rates of RIC capital gain distributions, where capital gains receive favorable treatment in the investor's residence country. Each of these tax effects, which results in a RIC's non-U.S. investors being disadvantaged vis-à-vis direct investors or investors in non-U.S. CIVs, is described briefly below.

First, non-U.S. investors in RICs are taxed in the United States when the RIC invests outside the United States. Because a RIC's distributions are treated as U.S.-source dividends, they are subject to U.S. withholding tax (at 30 percent or a lower treaty rate). Any non-U.S. investor investing in the same non-U.S. securities directly or through a non-U.S. CIV would not incur any U.S. tax. Thus, the income may be taxed in three countries (the source country, the United States, and the residence country) when the investment is made through a RIC, whereas the income would be taxed only twice (or perhaps once) if the investment is made directly or through a non-U.S. CIV. While a non-U.S. investor may be able to claim a foreign tax credit for the U.S. withholding tax, such a credit in all likelihood would not be available for the tax withheld by the source country on the payment to the RIC.

Second, non-U.S. investors in RICs in all likelihood will be taxed currently in their country of residence on the RICs' annual distributions. Residence country taxation occurs irrespective of whether that country otherwise permits deferral of tax through CIVs that do not distribute their income.

Finally, as we understand non-U.S. law, RIC capital gain dividends are treated in non-U.S. countries as "regular" dividends; the preferential "capital gains" nature of the distribution is not retained for non-U.S. tax purposes. Thus, RIC distributions of capital gains typically will not qualify for any tax preference provided in a residence country for capital gains.

A temporary legislative change effective for 2005 through 2011 made certain RICs more attractive to non-U.S. investors than they were previously. Specifically, legislation permitted a RIC to designate distributions of U.S.-source interest and short-term gain as such to non-U.S. investors (rather than as dividend income -- which was the treatment before the legislation was enacted and will be the treatment going forward unless extended by new legislation). This change had the effect of providing RIC shareholders from outside the U.S. with tax treatment comparable to that received by non-U.S. persons investing in the U.S. directly or through a non-U.S. CIV; these non-RIC investors already are exempt from U.S. tax on interest and short-term gains (as well as long-term gains -- on assets held for more than one year). Only long-term gains previously were exempt from U.S. withholding tax when paid by a RIC to a non-U.S. investor. Importantly, this legislation did <u>not</u> apply to non-U.S.-source interest income received by a RIC and distributed to its shareholders. All such income is treated as dividend income subject to U.S. withholding tax.

One last relevant feature of U.S. tax law involves information reporting of amounts paid to non-U.S. investors. U.S. payors (including brokers, banks, and funds) must report such payments to

investors (on IRS Form 1042-S) and to the IRS (on IRS Form 1042). This tax information is available to resident-country governments under exchange of information provisions in U.S. tax treaties.

B. U.S. Taxation of U.S. Persons in Non-U.S. CIVs

The passive foreign investment company ("PFIC") rules, which effectively tax PFIC gains currently at ordinary income rates, generally apply to holdings by U.S. investors of non-U.S. CIVs. Specifically, the value of a U.S. investor's PFIC shares generally is: (1) marked to market (at the investor's election) each year; or (2) subject to an interest charge designed to eliminate any tax deferral benefit. Mark-to-market appreciation and all distributions are taxable at ordinary income rates. Gain from the sale of PFIC shares also is taxable at ordinary income rates. An alternative taxation regime for PFICs that elect treatment as "qualified electing funds" ("QEFs") provides some opportunity for capital gain treatment; the QEF regime typically is not available to investors, however, as it requires the CIV to calculate its income under U.S. tax principles.

The PFIC rules impose such significant tax costs that U.S. taxpayers typically do not invest in non-U.S. CIVs. Even if the PFIC rules did not apply, U.S. securities laws prevent public offerings in the U.S. by non-U.S. CIVs unless the U.S. securities laws applicable to U.S. RICs (which are quite detailed) are followed by the non-U.S. CIVs. The combination of the tax and securities law rules provide powerful disincentives for U.S. taxpayer investment in non-U.S. CIVs.

III. RIC Treaty Eligibility

A. Satisfaction of Treaty Requirements

RICs qualify for treaty benefits as persons, residents, and the beneficial owners of their income.

1. *Person*

Paragraphs 1(a) of Article 3 of the Sweden-U.S. Convention defines a "person" to include "a trust . . . a company, and any other body persons." To qualify as a RIC under section 851 of the Internal Revenue Code, the CIV must be a "domestic corporation." Thus, RICs are persons under the Convention.

2. *Resident*

Paragraph 1 of Article 4 of the Convention defines resident to mean "any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management, place of incorporation, or any other criterion of a similar nature." The Organization for Economic Cooperation and Development ("OECD") recently addressed the "liable to tax" issue in the context of CIVs. Specifically, on 23 April 2010 the OECD's Committee on Fiscal Affairs adopted a report entitled "The Granting of Treaty Benefits with Respect to the Income of Collective Investment

Vehicles" in which it stated (in paragraph 29) that "a CIV that is opaque in the Contracting State in which it is established will be treated as a resident of that Contracting State even if . . . it receives a deduction for dividends paid to investors." The Protocol to the Convention further addresses the situation of partnerships and similar pass-through entities. In that (non-opaque) context, the partnership or similar entity is treated as a resident "to the extent that income derived by such partnership [or] similar entity . . . is subject to tax in that State as the income of a resident, either in its hands or in the hands of its partners or beneficiaries." Because RICs are liable to tax, and any income distributed by the RIC is liable to tax in the hands of RIC shareholders, RICs are residents under the Convention.

3. *Beneficial Ownership*

The Treasury Department's Technical Explanation of the Protocol, signed on September 30 2005, to the Convention, in discussing the "beneficial ownership" requirement of Article 10 (Dividends) provides that "the beneficial owner of the dividend . . . is the person to which the income is attributable for tax purposes." RICs, as discussed above, take the dividend income into account for their own tax purposes, retain full control over their income, and (as discussed in detail in III.C, below) are not transparent; in addition, they are not acting as agents for other investors. RICs thus are the beneficial owners of their income.

B. RICs are Owned Almost Exclusively by U.S. Investors

RICs are owned almost exclusively by U.S. investors for the tax and securities law reasons discussed above. Thus, Treasury effectively is protecting only the interests of U.S. taxpayers when it supports the tax treaty eligibility of U.S. RICs. Moreover, significant burden would be placed on individual RIC shareholders if they were required to claim treaty benefits on their own behalf.

C. RICs are Not Transparent

While the value of a RIC's shares includes the value of any income (such as dividends, interest, or capital gain) earned by the RIC, a shareholder has no right to receipt of that income until a dividend with respect to that income is declared. If an investor sells shares before the dividend is declared, the investor is not entitled to the dividend. Conversely, if the investor buys shares after the income is earned but before the dividend is declared, the investor is entitled to the dividend. Moreover, U.S. tax and securities laws prevent items of income or tax benefit from being allocated specially to individual shareholders. All shareholders in a RIC are entitled to an equal share of any tax benefit received by the RIC.

INVESTMENT
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By Electronic Delivery

July 19, 2012

Gd Ingemar Hansson
Skatteverket
S -171 94 Solna
SWEDEN

RE: *Supplemental Response on Regulatory Regime for U.S. Mutual Funds*

Dear Director-General Hansson:

This supplemental submission by the Investment Company Institute ("ICI")[1] responds to an inquiry from Skatteverket and supports further our request[2] for confirmation that U.S. mutual funds[3] qualify for the withholding tax exemption provided for dividends paid to "fund undertakings."[4] The additional information that was requested, which is provided in detail in the enclosed memorandum, involves: (1) mutual fund supervision; (2) placement rules and restrictions; (3) permissible and impermissible investments (by asset type); (4) internal controls and internal audit procedures; (5) custodian responsibilities and obligations; (6) NAV calculations; (7) purchase and redemption principles and procedures; and (8) permissible investors. Please let me know if you need any additional information regarding the rules and regulations governing U.S. mutual funds.

We have requested guidance applicable to all U.S. mutual funds. Such guidance will reduce substantially the administrative burden that otherwise will be imposed on U.S. funds, on their

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[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds ("ETFs"), and unit investment trusts ("UITs"). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $12.9 trillion and serve over 90 million shareholders.

[2] *See* ICI Letter to Director-General Hansson, dated June 1, 2012 (and enclosed with this letter).

[3] A "mutual fund" is an open-end investment company that permits daily purchases and redemptions of its shares at net asset value. Our request is limited to mutual funds that register under the applicable U.S. securities law – the Investment Company Act of 1940 – as open-end investment companies.

[4] http://www.regeringen.se/content/1/c6/17/55/29/dacaae9d.pdf

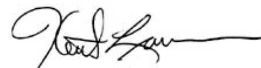
custodians and subcustodians, and on the Swedish Tax Agency; without such an announcement, every U.S. fund seeking the exemption could be required to file a separate claim and provide sufficient supporting evidence of its qualification as a fund undertaking.

Our request is fully consistent with the recent announcement that all UCITS funds[5] will receive the "fund undertakings" exemption. Presumably, the guidance provided to UCITS was designed to eliminate the need for each fund to establish separately that it qualifies as a fund undertaking. U.S. mutual funds, we submit, are in all relevant respects equivalent to UCITS funds and should receive the same relief.

* * *

Please feel free to contact me (at lawson@ici.org or 001-202-326-5832) if I can provide you with any additional information.

Sincerely,



Keith Lawson
Senior Counsel – Tax Law

Enclosures

cc: Ingemar Ronnang

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[5] A UCITS fund is one that satisfies the requirements of the Fourth Undertakings for Collective Investment in Transferable Securities ("UCITS") Directive ("the UCITS IV Directive").

July 19, 2012

DETAILED ICI RESPONSE TO SKATTEVERKET'S FOLLOW-UP QUESTIONS

This memorandum supplements information provided by the Investment Company Institute ("ICI")[1] pursuant to its June 1, 2012 request for confirmation that U.S. mutual funds qualify for the withholding tax exemption provided by Swedish domestic law for dividends paid to "fund undertakings."

These funds, as discussed in the June 1 ICI submission, are registered under the Investment Company Act of 1940 as "open-end investment companies." Shares of a U.S. mutual fund, as we noted, generally are available for purchase every day pursuant to a public offering. In all cases, shares of a U.S. mutual fund are redeemable upon shareholder demand. All such funds, for U.S. tax purposes, must satisfy various qualification and distribution requirements to be treated as regulated investment companies ("RICs")[2] under the Internal Revenue Code.

More specifically, this memorandum responds in detail to the June 15 request by a Skatteverket official for additional information regarding the rules and regulations governing U.S. mutual funds. The request was for information regarding: (1) mutual fund supervision; (2) placement rules and restrictions; (3) permissible and impermissible investments (by asset type); (4) internal controls and internal audit procedures; (5) custodian responsibilities and obligations; (6) NAV calculations; (7) purchase and redemption principles and procedures; and (8) permissible investors.

The Organization of a U.S. Mutual Fund

Each U.S. mutual fund is a separate legal entity, organized under state law either as a corporation or a business trust (sometimes called a "statutory trust"). Mutual funds have officers and directors (if the fund is a corporation) or trustees (if the fund is a business trust).[3] The fund's board plays an important role, described in more detail below, in overseeing fund operations.

Unlike other companies, a mutual fund is externally managed; it is not an operating company and it has no employees in the traditional sense. Instead, a fund relies upon third parties or service providers – either affiliated organizations or independent contractors – to invest fund assets and carry out other business activities.

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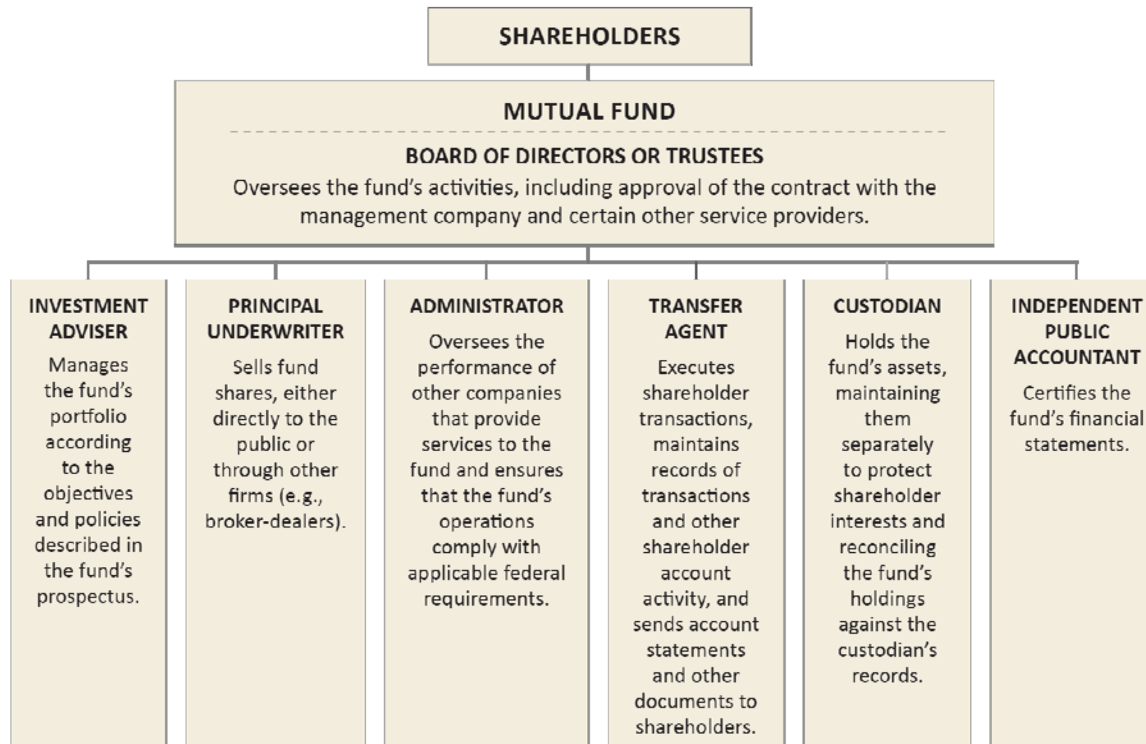
[1] The ICI is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $12.9 trillion and serve over 90 million shareholders.

[2] For securities law purposes, these funds are known as registered (rather than regulated) investment companies (but still as "RICs").

[3] Hereafter, for simplicity, both directors and trustees are referred to as "directors."

The following diagram shows the primary types of service providers usually retained by a mutual fund. These service providers include the investment adviser, the principal underwriter, the administrator, the transfer agent, the custodian, and the independent public accountant.



Core Principles Underlying the Regulation of Mutual Funds

Mutual funds are subject to a comprehensive regulatory scheme under the U.S. securities laws that provides important protections for shareholders and limits the potential for systemic risk. Mutual funds are regulated under all four of the major U.S. securities laws: the Securities Act of 1933, which requires registration of the fund's shares and the delivery of a prospectus; the Securities Exchange Act of 1934, which regulates the trading, purchase and sale of fund shares and establishes antifraud standards governing such trading; the Investment Advisers Act of 1940, which regulates the conduct of mutual fund investment advisers and requires them to register with the U.S. Securities and Exchange Commission ("SEC"); and, most importantly, the Investment Company Act of 1940 ("Investment Company Act"), which requires all mutual funds to register with the SEC and to meet certain operating standards.

The Investment Company Act goes far beyond the disclosure and anti-fraud requirements that are characteristic of the other U.S. federal securities laws by imposing substantive requirements and prohibitions on the structure and day-to-day operations of a mutual fund. The core principles of the Investment Company Act are:

(1) strict separation of the mutual fund's assets from the fund's investment adviser through explicit rules concerning the custody of portfolio securities;

(2) ensuring that the market and investors receive sufficient information about the mutual fund, including its strategy and investment risks, and that the information is accurate and not misleading;

(3) prohibiting complex, unfair, or unsound capital structures by, for example, placing constraints on the use of leverage;

(4) offering shareholders liquidity and objective, market-based valuation of their investments;

(5) prohibiting or restricting affiliated transactions and other forms of self-dealing;

(6) providing for specific diversification standards; and

(7) providing for a high degree of oversight and accountability.

Each of these core principles is discussed in more detail below.

Custody

The Investment Company Act, similar to UCITS requirements for the protection and safekeeping of fund assets,[4] requires all mutual funds to maintain strict custody of their assets, separate from the assets of the adviser. Although the Investment Company Act permits other arrangements, nearly all mutual funds use a bank custodian for domestic securities.[5] Foreign securities are required to be held only in the custody of certain eligible foreign banks or securities depositories.

A mutual fund's custody agreement with a bank is typically far more elaborate than the arrangements used for other bank clients. The custodian's services generally include safekeeping and accounting for the fund's assets, settling securities transactions, receiving dividends and interest, providing foreign exchange services, paying fund expenses, reporting failed trades, reporting cash transactions, and monitoring corporate actions at portfolio companies.

A mutual fund's portfolio assets are never considered assets of the investment adviser, custodian, or any other fund. No creditor of the adviser or custodian will have a claim against the assets

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[4] UCCITS IV generally requires a UCITS to entrust its assets to a depository that has been approved by the competent authority in its home member state; the competent authority must specify the depository's tasks and liabilities. *See* Directive 2009/65/EC.

[5] The Investment Company Act contains six separate custody rules for the different types of possible custody arrangements for mutual funds.

of the fund, and gains or losses of the fund cannot be used to offset losses or gains in any other fund or portfolio.[6] As a result, the failure of the mutual fund's custodian or investment adviser would have little impact on the portfolio.

The Investment Company Act's strict rules on custody and reconciliation of fund assets are also designed to prevent the types of theft and other fraud-based losses that have occurred in less regulated investment products. Shareholders are further insulated from these types of losses by a provision in the Investment Company Act that requires all mutual funds and closed-end funds to have fidelity bonds designed to protect them against possible instances of employee larceny and embezzlement.

Transparency

Similar to the disclosure and reporting provisions applicable to UCITS, mutual funds are subject to extensive disclosure requirements that ensure that the market and investors receive sufficient information about the fund.[7] The combination of registration statements, annual and semi-annual shareholder reports, quarterly portfolio holdings disclosure, and proxy voting disclosure, described below, provide the investing public, regulators, media, and other interested parties with far more information on mutual funds than is available for other types of investments in the U.S., such as separately managed accounts, bank-sponsored collective investment trusts, and private pools, such as hedge funds or private equity funds. The information filed by mutual funds is publicly available via the SEC's Electronic Data Gathering, Analysis, and Retrieval ("EDGAR') system. In addition, numerous private-sector vendors, such as Morningstar, are in the business of compiling publicly available information on mutual funds in ways designed to benefit investors and the market.[8]

Registration Statements

The cornerstone of the disclosure regime for mutual funds is the registration statement, which is comprised of the prospectus, the statement of additional information ("SAI"), and certain other information.[9] Mutual funds are required to maintain a current prospectus, which provides investors with information about the fund, including its investment objectives, investment strategies, risks, fees

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[6] Each mutual fund stands on its own. It will generate gains or losses based on the performance of its portfolio, less its expenses, independent of the fortunes of any other fund managed by the adviser or serviced by the custodian, and indeed, independent of the fortunes of the adviser or custodian.

[7] The SEC's website contains a description of information available to mutual fund shareholders, available at http://www.sec.gov/answers/mfinfo.htm.

[8] Investment advisers to mutual funds also are required to register with the SEC and disclose information about their business and operations.

[9] The registration statement for mutual funds (Form N-1A) is available at http://www.sec.gov/about/forms/formn-1a.pdf; for closed-end funds (Form N-2) at http://www.sec.gov/about/forms/formn-2.pdf; and for UITs (Form N-8B-2) at http://www.sec.gov/about/forms/formn-8b-2.pdf.

and expenses, and performance, as well as how to purchase, redeem, and exchange fund shares. Importantly, the key parts of this disclosure with respect to performance information and fees and expenses are standardized to facilitate comparisons by investors.[10] Certain information is required to be included in a specific manner (*e.g.*, a fee table with specified entries and nothing additional), location, and/or order in the prospectus. The prospectus must be provided to investors who purchase fund shares. In addition, most mutual funds deliver an updated prospectus to existing shareholders annually.

Mutual funds also are required to make their SAI available to investors upon request and without charge. The SAI conveys extensive and more detailed information about the fund. The SAI includes information about the history of the fund, offers detailed disclosure on certain investment policies (such as borrowing and concentration policies), lists officers, directors, and persons who control the fund, discloses the compensation paid to directors/trustees, certain officers, affiliated persons and service providers, and describes a range of information about a fund's portfolio managers, including their management of other accounts. In addition, funds must disclose in their SAI the extent of the board's role in the risk oversight of the fund, such as how the board administers its oversight function, and the effect that this has on the board's leadership structure.

Mutual fund registration statements are amended at least once each year to ensure that financial statements and other information have not become stale. These funds also amend registration statements throughout the year as necessary to reflect material changes to their disclosure.

Annual and Semi-Annual Reports

Mutual fund shareholders receive audited annual and unaudited semi-annual reports within 60 days after the end, and the mid-point, of the fund's fiscal year, respectively. These reports contain updated financial statements, a list of the fund's portfolio securities,[11] management's discussion of financial performance, and other information current as of the date of the report.

Portfolio Holdings and Proxy Voting Disclosure

Following their first and third quarter, mutual funds file an additional form with the SEC, Form N-Q, disclosing the complete schedule of their portfolio holdings.

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[10] Mutual funds are permitted to provide investors with a "summary prospectus" containing key information about the fund, while making more information available on the Internet and in paper upon request.

[11] A fund is permitted to include a summary portfolio schedule in its shareholder reports in lieu of the complete schedule of holdings in securities of unaffiliated issuers, provided that the complete portfolio schedule is filed with the SEC and is provided to shareholders upon request, free of charge. The summary portfolio schedule includes each of the fund's 50 largest holdings in unaffiliated issuers and each investment that exceeds one percent of the fund's net asset value. Each report discloses fully investments in, and advances to, affiliates as well as investments that are not securities, regardless of whether a summary schedule is used.

Mutual funds also are required to disclose annually how they voted on specific proxy issues at portfolio companies on Form N-PX. Funds are the only shareholders required to publicly disclose each and every proxy vote they cast.

Limits on Leverage

The Investment Company Act prohibits complex capital structures and, similar to the UCITS framework, includes provisions that limit the use of leverage. It imposes various requirements on the capital structure of mutual funds, including limitations on the issuance of "senior securities" and borrowing.[12] Generally speaking, a senior security is any debt that takes priority over the fund's shares, such as a loan or preferred stock.[13] These limitations minimize the possibility that a mutual fund's liabilities could exceed the value of its assets.

The SEC also takes the view that the Investment Company Act prohibits a mutual fund from creating a future obligation to pay unless it "covers" the obligation. A fund generally can cover an obligation by owning the instrument underlying the leveraged transaction. For example, a fund that wants to take a short position in a certain stock can comply with the Investment Company Act by owning an equivalent long position in that stock. The fund can also cover by segregating or earmarking, on its or its custodian's books, liquid securities equal in value to the fund's potential exposure from the leveraged transaction. The assets set aside to cover the leveraged security transactions must be liquid, unencumbered, and marked-to-market daily. They may not be used to cover other obligations and, if disposed of, must be replaced.

The Investment Company Act also limits borrowing. With certain very limited exceptions, any promissory note or other indebtedness generally would be considered a prohibited senior security. Mutual funds are permitted to borrow from a bank if, immediately after the bank borrowing, the fund's total net assets are at least three times total aggregate borrowings, *i.e.,* the fund must have at least 300 percent asset coverage.

Many mutual funds voluntarily go beyond the prohibitions in the Investment Company Act, adopting policies that restrict further their ability to issue senior securities or borrow. Mutual funds often, for example, adopt a policy stating that they will borrow only as a temporary measure for extraordinary or emergency purposes and not to finance investments in securities. In addition, they may disclose that borrowings will be limited to a small percentage of fund assets (such as five percent). These are meaningful voluntary measures because, under the Investment Company Act, a mutual

[12] The Investment Company Act also significantly restricts the ability of a RIC to invest in securities of other investment companies ("pyramiding").

[13] The SEC has historically interpreted the definition of senior security broadly, taking the view that selling securities short, purchasing securities on margin, and investing in many types of derivative instruments, among other practices, may create senior securities.

fund's policies on borrowing money and issuing senior securities (as well as other policies the fund may deem "fundamental") cannot be changed without the approval of fund shareholders.

Daily Valuation and Liquidity

Mutual funds offer shareholders liquidity and objective, market-based valuation of their investments. Mutual fund shares are redeemable on a daily basis at a price that reflects the current market value of the fund's portfolio securities; these values are calculated according to the requirements of the Investment Company Act and the policies established by each fund's board of directors.

The Investment Company Act includes detailed provisions for determining the value of each security in a mutual fund's portfolio.[14] The value is determined either by a market quotation, if a market quotation is readily available, or at "fair value" as determined in good faith by the board of directors. Under the Investment Company Act, the board of directors is specifically responsible for fair value determinations.

The daily pricing process is a critically important core compliance function that involves numerous staff, oversight by the mutual fund board, and, in some cases, pricing vendors.[15] The fair valuation process, a part of the overall pricing process, receives particular scrutiny from funds, their boards, regulators, and independent auditors. Under SEC rules, all mutual funds must adopt written policies and procedures that address the circumstances under which securities may be fair valued, and must establish criteria for determining how to assign fair value in particular instances.

The daily valuation process results in a net asset value, or NAV, for the mutual fund. The NAV is the price used for mutual fund share transactions—new purchases, sales (redemptions), and exchanges from one fund to another within the same fund family. It represents the current mark-to-market value of all the fund's assets, minus liabilities (*e.g.*, fund expenses), divided by the total number of shares outstanding.

The Investment Company Act requires mutual funds to process transactions based upon "forward pricing," meaning that shareholders receive the next computed share price (NAV) following the fund's receipt of their transaction order. Mutual funds must price their shares at least once per day at a time determined by the fund's board. Many funds price at 4:00 p.m. eastern time or when the New York Stock Exchange closes.

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[14] *See* Investment Company Act Section 2(a)(41) and Rule 22c-1 under the Investment Company Act.

[15] While mutual funds do retain independent pricing services to assist them in fulfilling their valuation responsibilities, those services simply provide an evaluation based on their own methodologies and judgment of a security's value. Mutual funds consider this evaluation together with other information in establishing the price of any particular security.

When a shareholder redeems shares in a mutual fund, he or she can expect to be paid promptly. Mutual funds may not suspend redemptions of their shares (subject to certain extremely limited exceptions)[16] or delay payments of redemption proceeds for more than seven days.

In furtherance of these requirements, SEC guidelines require a mutual fund to have no more than 15 percent of its assets in illiquid securities. A security is generally deemed to be liquid if it can be sold or disposed of in the ordinary course of business within seven days at approximately the price at which the mutual fund has valued it. Many funds adopt a specific policy with respect to investments in illiquid securities; these policies are sometimes more restrictive than the SEC requirements.[17]

Conflicts of Interest and Prohibitions on Transactions with Affiliates

Like UCITS IV, the Investment Company Act includes provisions to address conflicts of interest. The Investment Company Act contains a number of strong and detailed prohibitions on transactions between a mutual fund and fund insiders or affiliated organizations (such as the corporate parent of the fund's adviser).[18] These prohibitions are intended to prevent over-reaching and self-dealing by fund insiders.

Although there are a number of affiliated transaction prohibitions in the Investment Company Act, three are particularly noteworthy:

- Provisions generally prohibiting direct transactions between a fund and an affiliate;
- Provisions generally prohibiting joint transactions, where the fund and affiliate are acting together vis-à-vis a third party; and
- Provisions preventing investment banks from placing or "dumping" unmarketable securities with an affiliated fund.[19]

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[16] With the exception of a newly adopted provision for money market funds, the SEC must declare an emergency to exist to trigger an exception that allows a fund to suspend redemptions. Examples of circumstances deemed an emergency by the SEC include the assassination of President Kennedy in 1963, the blackouts that affected lower Manhattan in 1990, and certain natural disasters. A mutual fund would not be permitted to unilaterally suspend redemptions on the basis of a suspension being in the best interests of the integrity of the market.

[17] Money market funds have more specific liquidity requirements under Rule 2a-7 under the Investment Company Act, including specific daily and weekly requirements, and must limit their illiquid investments to five percent of the portfolio.

[18] In addition, a mutual fund's investment adviser has a fiduciary duty to put the fund's interest before the adviser's interest and is subject to numerous restrictions on transactions that may pose conflicts of interest.

[19] The Investment Company Act grants the SEC the ability to exempt certain transactions by rule or order, provided that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Investment Company Act.

Diversification

Both tax law and the Investment Company Act provide diversification standards for mutual funds. Under the tax laws, as discussed in detail in our 1 June 2012 submission,[20] all mutual funds seeking to qualify as "regulated investment companies" must meet a diversification test every quarter. The diversification test requires a fund with a modest cash position and no government securities to hold securities from at least 12 different issuers; as a practical matter, funds typically hold the securities of many more issuers.

The Investment Company Act sets higher standards for mutual funds that elect to be diversified. For these mutual funds, the Investment Company Act requires that, with respect to at least 75 percent of the portfolio, no more than five percent may be invested in the securities of any one issuer and no investment may represent more than ten percent of the outstanding voting securities of any issuer. Although securities-law diversification is not mandatory, but all mutual funds must disclose whether they are diversified under the Investment Company Act's standards.

Oversight and Accountability

All mutual funds are subject to a strong system of oversight from both internal and external sources. Internal oversight mechanisms include boards of directors, which include independent directors, and written compliance programs overseen by chief compliance officers, both at the fund and adviser levels. External oversight is provided by the SEC, the Financial Industry Regulatory Association,[21] and external service providers, such as certified public accounting firms.

Mutual Fund Boards

Mutual funds, as noted above, are organized as corporations (with boards of directors) or as business trusts (with boards of trustees). The Investment Company Act requires at least 40 percent of the members of a fund board to be independent from fund management. In practice, most fund boards have far higher percentages of independent directors or trustees. As of year-end 2008, independent directors made up 75 percent of boards in almost 90 percent of fund complexes.[22]

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[20] Under the "diversification" test of Internal Revenue Code section 851(b)(3), at least 50 percent of the value of the fund's total net assets must consist of cash, cash items, government securities, securities of other funds, and investments in other securities which, with respect to any one issuer, represent neither more than 5 percent of the assets of the fund nor more than 10 percent of the voting securities of the issuer. Further, no more than 25 percent of the fund's assets may be invested in the securities of any one issuer (other than government securities or the securities of other funds), the securities (other than the securities of other funds) of two or more issuers which the fund controls and are engaged in similar trades or businesses, or the securities of one or more qualified publicly traded partnerships.

[21] The Financial Industry Regulatory Association ("FINRA") is a self-regulatory organization that oversees those who distribute RIC shares and RIC advertising.

[22] *See* Fund Governance Practices: 1994-2008, Investment Company Institute and Independent Directors Council, available at http://www.ici.org/pdf/23833.pdf.

An independent director is a fund director who does not have any significant business relationship with a fund's adviser, underwriter, or affiliates. An independent director also cannot own any stock of the investment adviser or certain related entities, such as parent companies or subsidiaries.

Independent fund directors play a critical role in overseeing fund operations and are entrusted with the primary responsibility for looking after the interests of the fund's shareholders. They serve as "watchdogs" furnishing an independent check on the management of funds. Like directors of operating companies, they owe shareholders the duties of loyalty and care under state law. But independent fund directors also have specific statutory and regulatory responsibilities under the Investment Company Act; these duties are beyond those required of other types of directors. Among other things, for example, they oversee the performance of the fund, fair valuation determinations for securities held by the fund, and voting of proxies for the fund's portfolio securities. They also approve the fees paid to the investment adviser for its services, and oversee the fund's compliance program.[23]

Compliance Programs

The internal oversight function played by the board is complimented by a formal requirement that all mutual funds have a chief compliance officer ("CCO") and adopt a written compliance program reasonably designed to prevent, detect, and correct violations of the federal securities laws.[24] Compliance programs must be reviewed at least annually for their adequacy and effectiveness; mutual fund CCOs are required to report directly to the independent directors. Like mutual funds, investment advisers also must have their own written compliance programs that are overseen by CCOs to ensure compliance with all relevant laws and regulations.

At a minimum, a mutual fund's compliance program must address:

- portfolio management processes (*e.g.*, allocation of trades);
- trading practices (*e.g.*, best execution, trade aggregation);
- proprietary and personal trading;
- accuracy of disclosure to investors;
- safeguarding of assets;
- accurate and safe records;
- valuation processes;

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[23] For more information on governance, *see* http://www.ici.org/idc/policy/governance/overview_fund_gov_idc and http://www.ici.org/idc/policy/governance/faq_fund_gov_idc.

[24] A mutual fund's compliance program must be adopted by the fund's directors, including a majority of the fund's independent directors. *See* Board Oversight of Fund Compliance, Independent Directors Council, Task Force Report, September 2009, available at http://www.ici.org/pdf/idc_09_compliance.pdf.

- privacy safeguards; and
- business continuity plans.

In addition, the SEC expects fund compliance programs to address:

- pricing of portfolio securities;
- processing fund share transactions;
- identifying affiliated persons;
- protecting non-public information;
- fund governance requirements; and
- market timing.[25]

A mutual fund's board also often is engaged in the selection and ongoing oversight of its service providers, such as the fund's custodian. For example, in evaluating a service provider for the first time, the board may consider a wide variety of information regarding the resources, capabilities and reputation of the service provider. Similarly, a board may be involved in evaluating whether to renew a service provider's contract; the board thus can shift focus to an evaluation of the service provider's performance over the existing period, as well as to whether or not any different fees may be appropriate. Ongoing oversight also is important. In particular, the board at least annually receives a written report from the CCO regarding the operation of the compliance policies and procedures of its investment advisers, principal underwriters, administrators and transfer agents; the board is required to approve and annually review the policies and procedures of these service providers.[26] In addition, many boards receive periodic reports at regular board meetings from fund management regarding service providers' delivery of services and level of performance. The board also may receive periodic reports or presentations from representatives of the service providers.

Regulatory Oversight

Internal oversight of mutual funds is accompanied by a number of forms of external oversight and accountability. Mutual funds are subject to inspections, examinations, and enforcement by their primary regulator, the SEC. Depending on their circumstances, mutual funds also are subject to varying levels of oversight by self-regulatory organizations (such as FINRA and stock exchanges), state securities regulators, and banking regulators (to the extent the fund is affiliated with a bank).[27]

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[25] These are the minimum requirements; mutual funds may have additional policies and procedures based on the particular fund (*i.e.*, policies and procedures regarding the use of derivatives).

[26] For additional discussion regarding a board's oversight of mutual fund service providers, *see* Board Oversight of Service Providers, Independent Directors Council, Task Force Report, June 2007, available at http://www.ici.org/pdf/21229.pdf. This paper provides practical guidance and insight into a fund board's oversight responsibilities with respect to service providers, such as a fund's administrator, custodian and transfer agent.

[27] In addition, like officers of public companies, officers of mutual funds are required to make certifications and disclosures required by the Sarbanes-Oxley Act. For example, officers must certify the accuracy of the financial statements.

Auditors

Mutual funds' financial statement disclosure also is subject to several internal and external checks. Annual reports, for example, include audited financial statements certified by a certified public accounting firm subject to oversight by the Public Company Accounting Oversight Board ("PCAOB"). This ensures that the financial statements are prepared in conformity with generally accepted accounting principles ("GAAP") and present fairly the fund's financial position and results of operations. It also serves as a check on valuation because, as part of the process, auditors independently verify the prices for all portfolio securities held by the fund at the report date.

Additional Regulation of Advisers

In addition to the system of oversight applicable directly to mutual funds, investors enjoy protections through SEC regulation of the investment advisers that manage fund portfolios. All advisers to mutual funds are required to register with the SEC, and are subject to SEC oversight and disclosure requirements.[28] Advisers also owe a fiduciary duty to each fund they advise, meaning that they have a fundamental legal obligation to act in the best interests of the fund pursuant to a duty of undivided loyalty and utmost good faith and to make full and fair disclosure of all material facts.

Mutual Fund Assets

Mutual funds generally may invest in stocks, bonds, short-term money market instruments, other securities or assets, or some combination of these investments. Specifically, the Investment Company Act defines an "investment company" (of which a mutual fund is one type) as any issuer which "is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities."[29] The term "security" is defined as "any note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security (including a certificate of deposit) or on any group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or

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[28] The investment adviser registration form (Form ADV) requires information about the adviser's business, ownership, clients, employees, business practices, affiliations, and disciplinary events.

[29] Section 3(a)(1)(A) of the Investment Company Act of 1940.

purchase, any of the foregoing.[30] A mutual fund may invest no more than 15% (5% for money market funds) of its net assets in illiquid securities.

A mutual fund's investment activities are constrained, beyond the requirement to invest primarily in securities, by the fund's investment objective and policies. In particular, a mutual fund is required to disclose the policy of the fund in respect of each of the following types of activities: (a) the classification and sub-classifications (*e.g.,* whether diversified or non-diversified under the securities laws) within which the registrant proposes to operate; (b) borrowing money; (c) the issuance of senior securities; (d) engaging in the business of underwriting securities issued by other persons; (e) concentrating investments in a particular industry or group of industries; (f) the purchase and sale of real estate and commodities, or either of them; (g) making loans to other persons; and (h) portfolio turnover (including a statement showing the aggregate dollar amount of purchases and sales of portfolio securities, other than Government securities, in each of the last three full fiscal years preceding the filing of such registration statement).[31] In addition, to prevent "pyramiding" of funds, the Investment Company Act restricts the ability of a fund to invest in securities of other registered investment companies.[32]

Offering of Mutual Fund Shares

In order to offer or sell its securities, a mutual fund must register under the Investment Company Act of 1940.[33] In addition, a mutual fund generally also registers its shares under the Securities Act of 1933 so that it may offer its shares to the public.[34] While mutual fund shares almost always are held widely by the public, some funds may require minimum investment amounts or target institutional investors. Some UCITS likewise limit access to their shares.

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[30] Section 2(a)(36) of the Investment Company Act of 1940.

[31] Such recital consists in each case of a statement whether the mutual fund reserves freedom of action to engage in activities of such type; if such freedom of action is reserved, a statement indicates briefly, insofar as is practicable, the extent to which the fund intends to engage therein. *See* Section 8 of the Investment Company Act of 1940.

[32] *See* Section 12 of the Investment Company Act of 1940.

[33] *See* Section 8 of the Investment Company Act of 1940.

[34] Absent registration under the Securities Act of 1933, a mutual fund would be unable to engage in a public offering of its shares. Mutual funds very rarely refrain from registering their shares under the Securities Act of 1933.