INVESTMENT COMPANY INSTITUTE

Keith Lawson
SENIOR COUNSEL – TAX LAW

1401 H Street, NW, Washington, DC 20005-2148, USA
202/326-5800 www.ici.org

202/326-5832 FAX: 202/326-5841
lawson@ici.org

January 15, 2009

By Electronic Delivery

James H. Freis, Jr.
Director
Financial Crimes Enforcement Network
U.S. Department of the Treasury
1500 Pennsylvania Avenue
Washington, DC 20220

Jamal El-Hindi
Associate Director for Regulatory Policy and Programs
Financial Crimes Enforcement Network
U.S. Department of the Treasury
1500 Pennsylvania Avenue
Washington, DC 20220

RE: *Clarify FBAR Rules' Application to* *Funds Registered Under 1940 Act*

Dear Mr. Freis and Mr. El-Hindi:

The Investment Company Institute[1] ("ICI") requests guidance clarifying the reporting obligations under Form TD F 90-22.1 -- Report of Foreign Bank and Financial Accounts (the "FBAR") -- for foreign accounts of those investment companies ("funds") that are registered under the Investment Company Act of 1940 ("the 1940 Act").[2] Specifically, we request clarification that persons who are employees of firms that provide services to funds, and who have signature or other authority (hereafter "signature authority") over a fund's foreign accounts, [3] may utilize the employee exception[4] to the FBAR filing requirement. [5]

[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 $9.86 trillion and serve over 93 million shareholders.

[2] 15 U.S.C. sections 80a-1 *et seq*.

[3] The FBAR instructions generally require that each U.S. person who has a financial interest in or signature authority over foreign accounts report that relationship if the aggregate value of the accounts exceeds $10,000 at any time during the calendar year. Such persons must file the FBAR on or before June 30 of the succeeding year. These persons also must disclose this authority on Part III of Schedule B to Form 1040.

[4] The FBAR's instructions except from the reporting requirements the officers and employees of certain domestic corporations. Under one part of the exception, the corporation must either (1) list its equity securities on a national securities exchange or (2) have assets exceeding $10 million and 500 or more shareholders. Under the second part of the exception, (1) the officer or employee must have no personal financial interest in the account and (2) the chief financial

The requested guidance is necessary because of confusion within the industry regarding how the FBAR's employee exception applies in the fund context. Funds, for reasons discussed below, do not have employees of their own. Instead, the tasks of running a fund are performed by individuals who are employees of a fund service provider. In all relevant respects, the individuals' responsibilities would be identical if they were employees of the fund itself, rather than of the fund service provider. Moreover, the rationale for the employee exception appears to apply uniformly to employees of fund service providers and to those employees expressly covered by the employee exception. Nevertheless, because individuals providing services to funds and having signature authority over fund accounts are not actually employees of the fund, they appear not to be eligible for the employee exception unless either they are treated as fund employees for this specific FBAR purpose or the employee exception is applied in this context at the service provider level.

The guidance requested would both eliminate this uncertainty and reduce compliance burdens for the government, fund service providers, and their employees. Our requested guidance also is consistent with the FBAR's purposes of thwarting abusive tax schemes and combating terrorism[6] and the Treasury Department's goals for improving compliance. In the absence of FBAR guidance that expressly addresses funds, Treasury will be inundated with unnecessary and duplicative submissions; fund service providers and their employees seeking to comply with FBAR requirements will face continued uncertainty and traps for the unwary.

I. <u>Background</u>

A. *Funds Registered Under the 1940 Act*

Investment companies that register under the 1940 Act are entities that hold a diversified pool of investment assets (*e.g.,* stocks, bonds, or other securities) for their investors. Every fund's prospectus describes the fund's investment objective and the types of assets the fund will hold. While funds typically have officers and a board of directors or trustees, who oversee fund operations, they do not have employees.

---

officer ("CFO") of the corporation must advise the officer or employee in writing that the company has filed a current FBAR that includes the account.

[5] Because the rationale for this request also applies to the foreign accounts of other investment pools managed by advisers to funds that are registered under the 1940 Act, these other situations also should be covered by the guidance requested.

[6] Among other revisions, Congress enacted a civil penalty for non-willful violations and increased the penalty for willful violations related to FBAR filings in the American Jobs Creation Act of 2004. The Senate Finance Committee explained that these changes were intended to improve compliance with the FBAR reporting requirement, which is "vitally important to sound tax administration, to combating terrorism and to preventing the use of abusive tax schemes and scams." *See* Senate Finance Committee Report, S. Rep. No. 108-192, p. 108.

The most common type of fund is the mutual fund.[7] Other types of funds are closed-end funds,[8] unit investment trusts ("UITs")[9] and exchange-traded funds ("ETFs").[10] While differences exist in how investor interests (*e.g.,* shares) in these funds are purchased or sold, all such funds are subject to the same extensive regulatory regime. In particular, funds are subject to the regulatory regime provided by the 1940 Act and the regulatory supervision provided by the Securities and Exchange Commission ("SEC").

B. *Relationship Between Funds and Their Service Providers*

Funds, as noted above, do not have employees. All services (other than those performed by officers and directors or trustees) are performed by employees of firms that have contracted with the funds. These service providers may or may not be affiliated with each other.

The typical fund is organized by a fund manager to provide investment opportunities for the manager's current and future customers. The funds organized by the same manager often are called members of the same "fund family." The organizing firm or an affiliate may serve as the fund's administrator; in other cases, firms contract with a third party to serve as the fund's administrator. Among the day-to-day functions performed by the administrator are overseeing other service providers and ensuring that the fund's operations comply with applicable regulatory requirements. Significant responsibility for the fund's financial accounts rests with the administrator.

While the manager often also provides the investment advice regarding the fund's assets, other firms may contract with the fund to advise or sub-advise some or all of the fund's assets. In all cases, the adviser manages and invests the fund's assets in accordance with the fund's investment objectives. The fund's adviser has its own employees who service the fund and its shareholders.

One function typically not performed by an affiliate of the fund's manager is the custodial function. All funds are required to protect their portfolio securities by placing them with a custodian

---

[7] Mutual funds have a fluctuating number of shares outstanding. Most mutual funds continuously offer their shares to the public; all mutual funds are required to redeem their shares at any time for the shares' net asset value ("NAV"), which is determined by dividing the fund's net assets by the number of shares outstanding.

[8] Closed-end funds, unlike mutual funds, have a generally fixed number of shares. Closed-end fund shares are not redeemable; they typically trade on stock exchanges. Because the prices at which these shares trade are determined by market supply and demand, closed-end fund shares may trade at a discount or premium to their NAV.

[9] UITs hold a generally fixed portfolio of securities. Like closed-end funds, UITs have a generally fixed number of units outstanding. Like mutual funds, however, interests in UITs are redeemable at NAV, although they also may be purchased and sold in a secondary market.

[10] ETFs are a relatively recent innovation to the investment company concept. ETF shares are redeemable only in large blocks; retail investors buy and sell ETF shares on stock exchanges. The redemption feature helps to ensure that ETF shares trade at prices close to NAV.

(typically a bank) and complying with various custody requirements of the 1940 Act. The custodian often is called the "global custodian." The global custodian may engage other custodians ("subcustodians") to hold a portion of the fund's assets (often those located in one or more foreign countries).

C. *Regulation of Funds*

1. *In General*

The statute most directly affecting the operation of a fund, and protecting a fund's assets for its investors, is the 1940 Act. This statute, as noted above, regulates a fund's structure and operations by imposing restrictions on the fund's investments and requiring that the fund, among other things, maintain detailed books and records, safeguard portfolio securities, and file periodic reports with the SEC.

Another relevant statute, the Investment Advisers Act of 1940 (the "Advisers Act"),[11] provides a regulatory regime for investment advisers, including advisers to funds. The Advisers Act requires advisers to satisfy recordkeeping, custodial, reporting and other regulatory responsibilities.[12]

2. *Custody Requirements for Foreign Assets of U.S. Funds*

Funds are subject to extensive SEC requirements regarding the custody of their foreign assets. Specifically, Rule 17f-5 under the 1940 Act governs the custody of a fund's assets held outside of the United States. Rule 17f-5 imposes several conditions on arrangements between a fund, its global custodian and the various subcustodians; these conditions include requiring that: (1) the fund's board determine that it is reasonable to rely on the global custodian to perform its duties regarding subcustodians; (2) the global custodian transmit certain periodic reports to the fund's board; and (3) the global custodian agree to exercise "reasonable care, prudence, and diligence" in performing its duties.

The global custodian is responsible for selecting its subcustodians and determining that the subcustodians will exercise "reasonable care, based on the standards applicable to custodians in the relevant market." Rule 17f-5 requires global custodians to evaluate, among other things, its subcustodians': (1) practices, procedures and internal controls; (2) financial strength; and (3) general reputation and standing. Global custodians also must monitor their foreign subcustodians on a continuous basis and remove assets from any subcustodian that fails to meet Rule 17f-5's

---

[11] 15 U.S.C. sections 80b-1 *et seq*.

[12] The SEC examines funds and their advisers for compliance with these securities laws. SEC examiners could be tasked as well with ensuring compliance by funds and their advisers with FBAR. Examination authority already has been delegated by FINCEN to the SEC to ensure FBAR compliance by broker-dealers.

requirements. Rule 17f-5 also requires that contracts between a fund's global custodian and its foreign subcustodians include certain provisions, such as: (1) indemnity and insurance coverage; (2) protections against creditor claims; (3) independent auditor access to accounts; and (4) delivery of periodic reports to the fund.

The foreign accounts of a fund also may be subject to the securities laws of foreign countries, which often provide specific rules regarding the custody of assets held within their jurisdiction. For example, the local laws of a foreign government often mandate that a global custodian use locally-organized securities depositories, which typically are treated as subcustodians for Rule 17f-5 purposes.

Advisers to funds, and often global custodians, typically have little or no control over the establishment or use of depositories in a particular foreign market. The U.S. securities laws are drafted to reflect these realities. Rule 17f-7 provides rules regarding the custody of a fund's assets with a foreign securities depository. The rule provides certain criteria that must be satisfied for a depository to be treated as an "eligible securities depository" for fund assets. Rule 17f-7 requires, for example, that a global custodian: (1) determine that its foreign depositories meet the objective criteria; (2) monitor the foreign depositories to ensure their continued compliance with the rules; and (3) give a fund's board reports analyzing the custody risks associated with the use of each eligible securities depository.

D. *Types and Number of Foreign Accounts Holding Fund Assets*

The number and types of foreign accounts held by a fund is a function of many factors. U.S. securities laws and/or the laws of the foreign jurisdictions where the accounts are held require the maintenance of certain types of accounts (*e.g.,* a cash and securities account). A fund's particular investment strategy also affects the number of a fund's accounts. If a fund, for example, invests in securities of companies located in 25 countries, and has a single cash account and a single securities account in each country, the fund would have 50 foreign accounts. Many funds have far more foreign accounts.

E. *Persons With Signature Authority Over a Fund's Foreign Accounts*

Many employees of one or more fund service providers have signature authority over some or all of a fund's bank and securities accounts, including the fund's foreign accounts. In no case do these employees have a direct financial interest in these accounts. If an employee of the service provider also happens to invest in the fund, the employee's financial interest in the fund is limited to his or her proportionate interest in the fund and is the same as the interest of every other fund shareholder. Moreover, the extensive securities laws applicable to the fund's assets adequately safeguard the assets from being used for improper purposes and a fund's board approves signatories.

Persons with signature authority may include: (1) the fund's portfolio manager(s); (2) traders who execute the purchase and sale of securities on the fund's behalf; and (3) accounting staff or backoffice employees who are responsible for allocating funds to pay for a fund's expenses and other administrative duties that require disposition of the fund's assets. Some of these persons (such as portfolio managers) also may be officers of the fund.

If a fund family has multiple funds with non-U.S. investments, many employees of fund service providers (such as the traders and accounting personnel) may have signature authority over foreign accounts for multiple (even scores of) funds. If an employee had signature authority for 20 funds and each fund had two foreign accounts in each of 10 countries, the employee would have signature authority over 400 foreign accounts (20 accounts for each of 20 funds).

II. Discussion

A. *Proposal: Clarify That Employee Exception Applies to Fund Service Provider Employees*

We urge that the FBAR instructions be clarified to provide expressly that employees of a fund service provider may claim the employee exception when they have signature authority over a fund's foreign accounts.[13] This exception should be available to all such employees regardless of fund size. All funds are taxed as domestic corporations and have publicly-traded shares. Almost all funds have assets exceeding $10 million and 500 or more shareholders. Most fund service providers also are domestic corporations with publicly traded shares and/or have assets exceeding $10 million. Limiting the employee exception based upon conditions at either the fund or the fund service provider level could lead to confusion and unintended consequences.

Employees of fund service providers, like employees of large companies clearly within the scope of the exception, possess signature authority over a fund's foreign accounts solely in their capacity as employees. These individuals, as discussed above, do not have any personal financial interest in such accounts. Second, funds and their service providers are governed by numerous securities laws designed to protect shareholders and prevent illegal use of fund assets. Finally, the FBAR reporting performed by the fund itself, and/or by the fund service provider, provides all of the information (or access thereto) regarding the accounts for which the employees have overlapping signature authority.

These employees also should be eligible for the employee exception with respect to any financial accounts for investment vehicles not registered under the 1940 Act. The controls put into place by the fund service provider to ensure compliance with the 1940 Act also are applied by the fund service provider to their employees' activities for these other funds. Moreover, as the fund

[13] Clarification also would be helpful on a more minor issue. Specifically, some confusion has arisen regarding whether the employee exception is available if a filer holds a financial interest in 25 or more foreign accounts. The confusion arises because each specific account is not listed when a consolidated report is filed. While Q&A guidance released by IRS in connection with an October 22, 2007 FBAR Phone Forum indicates that the employee exception is available, confirmation in the FBAR instructions would be very helpful.

service provider still must report the financial accounts for all of the funds for which any of its employees have signature authority, the government will receive FBAR reporting on these other funds without the confusion and duplication that would arise if the employee exception is not available.

ICI suggests the following revision to the exceptions section of the FBAR instructions to implement this recommendation:

> A United States person who is an employee of an authorized service provider is not required to file such report if (1) the person's signature or other authority relates to an account over which the person has no financial interest (other than as a shareholder in the investment company), and (2) an authorized service provider informs the person in writing that an authorized service provider will file the report.
>
> For purposes of this exception, an "authorized service provider" is an entity that provides services to an investment company registered under the Investment Company Act of 1940 and for which one or more employees of the service provider have signature or other authority for one or more such investment companies.

Importantly, the ICI's proposal would permit an authorized service provider to inform its employees that it *will* file a report. All of the information that a service provider would need to file the FBAR for all of the foreign accounts for all of the funds for which it provides services generally cannot be obtained in time to file its FBAR before its employees beginning filing their federal income tax returns. For example, because some employees may file their returns shortly after the January 31 deadline for providing wage information to taxpayers, authorized service providers effectively might be required to file the FBAR by January 31 so that it could tell its employees that the form had been filed.

B. *ICI's Employee Exception Proposal is Consistent With FBAR's Purposes*

ICI's proposed employee exception for fund service providers is consistent with the FBAR's purposes. Treasury has stated that the FBAR is intended to elicit information "determined to have a high degree of usefulness in criminal, tax, regulatory, intelligence, and counter-terrorism matters, and to implement counter-money-laundering programs and compliance procedures.[14] U.S. and foreign securities laws extensively regulate a fund's foreign accounts.[15] A fund's adviser or other service provider reports these accounts. The burdens of requiring employees of fund service providers also to

[14] U.S. Department of the Treasury, *A Report to Congress in Accordance With §361(b) of the Uniting and Strengthening America By Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA Patriot Act)*, April 26, 2002 ("2002 Treasury Report"), page 3.

[15] In addition to the custody requirements over a fund's assets, including cash received and disbursed, funds must satisfy the U.S. securities laws that govern the investment of the fund's assets in conformance with its prospectus.

file volumes of duplicative reports for the same accounts outweigh any conceivable enforcement benefits.

ICI's proposed employee exception for fund service providers also is consistent with Treasury's FBAR compliance initiatives. Treasury has observed that "there appear to be a number of taxpayers who fail to file because of lack of knowledge or confusion about the filing requirements."[16] Treasury has recommended a number of actions that would assist taxpayers in understanding their reporting obligations, including: (1) eliminating duplicative information; (2) incorporating user-friendly instructions; (3) using understandable definitions; (4) developing a reporting format (*e.g.*, a continuation sheet) for use by multiple filers; and (5) providing updated terminology and additional types of financial transactions in the form's instructions. Our proposal advances several of Treasury's stated goals by, among other things: (1) eliminating duplicative reports; (2) clarifying the instructions; and (3) adding definitions and rules specifically for funds, which are not addressed expressly by the current form.

If an employee exception is not provided for fund service provider employees, the government will be unnecessarily burdened. Treasury will be inundated with voluminous and duplicative filings for accounts that already are reported separately. Treasury will expend considerable administrative efforts processing reports that do not have a high likelihood of advancing Treasury enforcement goals. A single report filed by a fund service provider will provide Treasury with information regarding a fund's foreign accounts without impeding Treasury's ability to use the FBAR effectively as a tool for combating abusive tax schemes and terrorism.

If an employee exception is not provided, fund service providers and their employees also will incur significant administrative burdens and costs; many of these costs ultimately will be borne by the fund's shareholders. Fund service providers would need to inform employees of their reporting obligations and assist them in completing and filing FBAR forms; many employees will file scores or hundreds of such forms. Many of these employees presently are unaware that the FBAR's filing obligations may apply to them.

C. *ICI's Employee Exception Proposal is Consistent With Analogous Guidance*

ICI's proposal also is consistent with various IRS interpretive bulletins that have taken expansive views of the employee exception. One bulletin, for example, provides that employees of domestic subsidiaries of corporations defined in the FBAR instructions also may be excluded from the FBAR's reporting requirements.[17] A more recent IRS interpretive bulletin clarified that the employee exception also applies to an officer or employee of a: (1) wholly-owned foreign subsidiary with

---

[16] 2002 Treasury Report, page 10-11.

[17] *See* IRS Headliner Volume 127, dated June 9, 2005, *citing* a pre-1988 interpretive ruling in Appendix A of 31 C.F.R. 103.

signature authority over an account owned by the same foreign subsidiary; (2) wholly-owned domestic subsidiary with signature authority over an account owned by a wholly-owned foreign subsidiary; and (3) wholly-owned domestic subsidiary with signature authority over an account owned by another wholly-owned domestic subsidiary of which he is not an officer or an employee.[18]

The interpretive bulletins' clarifications that the employee exception applies to employees of certain domestic and foreign subsidiaries are consistent with the apparent purposes of the express exception in the FBAR instructions. The employees of these subsidiaries also do not possess the type of control or interest in the parent or subsidiary corporation's accounts to engage in the kinds of illegal activities targeted by the FBAR.

A fund service provider reasonably could conclude that its employees are eligible for the employee exception from FBAR reporting, based upon a considered reading of the FBAR instructions, the apparent purpose of the employee exception, and the expansive guidance provided by IRS interpretive bulletins. In particular, the June 2007 Headliner's example of an officer or employee of a domestic subsidiary with signature authority over the foreign account of another wholly-owned domestic subsidiary of which he is not an officer or employee is analogous to fund service provider employees who have signature authority over foreign accounts of a fund, of which they are not employees. Nevertheless, given the uncertainty and the burdens caused by a literal reading of the instructions, clarification is necessary.

III. Conclusion

We strongly urge Treasury to revise the FBAR instructions to provide an express employee exception for fund service provider employees. Our requested guidance is needed to address increasing industry concerns and uncertainty regarding application to fund service providers and their employees of the ambiguous FBAR reporting obligations.

The ICI appreciates your consideration of our concerns. We will be contacting you very soon to discuss our requested guidance. Please contact the undersigned at 202-326-5832 if you have any questions regarding this letter or you would like additional information regarding the organization or operation of funds registered under the 1940 Act or their service providers.

Sincerely,

/s/ Keith Lawson

Keith Lawson
Senior Counsel - Tax Law

---

[18] *See* IRS Headliner Volume 207, dated June 20, 2007.