INVESTMENT COMPANY INSTITUTE

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May 23, 2011

By Electronic Delivery

James H. Freis, Jr.
Director
Financial Crimes Enforcement Network
U.S. Department of the Treasury
P.O. Box 39
Vienna, Virginia 22183

RE: *Application of Final FBAR Rules to 1940 Act Funds*

Dear Mr. Freis:

The Investment Company Institute[1] ("ICI") requests confirmation of three points and additional guidance on three others concerning application to the investment company industry of the final regulations (the "Final Regulations") issued under the Bank Secrecy Act (the "BSA") for the reporting of foreign financial accounts. These comments should not be read in any way as diminishing our great appreciation for the Financial Crimes Enforcement Network's ("FinCEN") efforts to finalize these rules in a manner that maximizes the compliance benefit of the Report of Foreign Bank and Financial Accounts – Form TD-F 90-22.1 ("FBAR") while minimizing the burdens associated with completing the report.

We request clarification of three important points because of ambiguities raised by the preamble to the Final Regulations. First, we request clarification that a so-called "segregated account" in a foreign country that is created by a U.S. global custodian for the benefit of an investment company is not a foreign financial account of the investment company so long as the investment company cannot access directly the foreign account. Second, we request clarification that officers of investment companies may utilize the signature authority exception provided by section 1010.350(f)(2)(ii) of the Final Regulations for officers of financial institutions. Third, we request clarification that an officer or employee of a U.S. parent company that is either a financial institution or publicly traded has no FBAR

[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 $13.1 trillion and serve over 90 million shareholders.

reporting obligation for any foreign account of a domestic or foreign subsidiary of the parent for which the individual has signature authority (so long as he or she has no financial interest in the account).

We also request guidance on three additional points. First, we request that officers and employees of a subsidiary, the parent of which is a financial institution or publicly traded, should receive the same signature authority exception provided to officers and employees of the parent with respect to *all* of the parent's financial interests. Second, we request that the reporting exception for officers and employees of foreign subsidiaries (provided by the 2008 FBAR instructions) be restored. Third, we request that officers and employees of non-bank affiliates of banks that perform transfer agency and other administrative functions for their investment company clients, when the affiliate is registered with an "appropriate regulatory authority" and examined by its Federal functional regulator or the Securities and Exchange Commission ("SEC"), be eligible for the "authorized service provider" reporting exception provided by section 1010.350(f)(2)(iii).

I. Financial Interest – Omnibus and Segregated Accounts

The Institute requests clarification that a "segregated account" created by a U.S. investment company's U.S. global custodian to hold the investment company's assets in a non-U.S. market is not a foreign financial account of the investment company subject to FBAR reporting by the investment company so long as the investment company cannot access directly the account assets. This clarification is requested because of ambiguities regarding how various types of custodial arrangements should be treated. The preamble to the final regulations suggests that direct access is one of the keys to having a financial interest in a foreign account. Direct access is key, we submit, regardless of the precise manner in which the assets are held.

Background

U.S. investment companies retain U.S. global custodians to hold their assets. These global custodians, in turn, create accounts in foreign countries in which their U.S. clients invest; these accounts may be created by a local office affiliated with the global custodian or by a local subcustodian retained by the global custodian. Under industry practice, as described below, the U.S. investment company has no contractual relationship with the local subcustodian. All contracts are between the U.S. global custodians and the local subcustodians. All instructions regarding these accounts are issued to the local subcustodian by the U.S. global custodian.

A global custodian typically holds its clients' assets outside the United States in one of three ways: (1) pooled or omnibus accounts, in which multiple clients' assets are placed together in one account in the name of the custodian; (2) "for benefit of" or "FBO" segregated accounts, in which the account is titled in the custodian's name for the benefit of a specific client; and (3) "direct registration" segregated accounts, in which the account is titled in the client's name. Direct registration is required in approximately twenty developing markets to meet specific local tax and regulatory criteria.

Regardless of the account structure, access to the account is governed by the specific contractual agreement between the global custodian and the local subcustodian. These agreements, pursuant to long-standing industry practice, preclude U.S. clients from accessing directly their subcustodial accounts. In some cases, the U.S. client will not even know whether the account is registered as an omnibus account, an FBO account, or a direct-registration account. Even where the account is registered directly in the U.S. client's name, the client will not be a party to the contract with the subcustodian and will not have any ability to direct the subcustodian to act in any way.

The so-called "SWIFT" system,[2] which is the globally-recognized mechanism for communicating and effecting financial instructions between custodial banks, likewise effectively precludes investment companies from accessing accounts created by the U.S. global custodian. All parties utilizing SWIFT must have correspondent accounts. Because no contractual relationship exists between the local subcustodian and the U.S. investment company, no corresponding account relationship is established. Moreover, the contract between the global custodian and the subcustodian often will include a specific clause requiring that all instructions be SWIFT communications directly from the global custodian. For these reasons, the investment company could not utilize SWIFT to access any account, even one registered in its name. The only way that the U.S. client can direct the disposition of assets in the subcustodial account is to contact the global custodian; the global custodian, in turn, will send instructions to the subcustodian through SWIFT.

Discussion

The preamble to the Final Regulations creates some uncertainty regarding the types of accounts created by a U.S. global custodian for a U.S. client that are treated as foreign financial accounts of the client. The Final Regulations treat a U.S. person as having a financial interest in a foreign account if the person is the "owner of record or has legal title."[3] The preamble to the Final Regulations, however, states that a U.S. person does not have a financial interest in an omnibus account so long as the client "can only access [the] holdings outside of the United States through the U.S. global custodian."[4]

Although the preamble notes that omnibus accounts are "in the name of the global custodian," FBO accounts (which might or might not be subaccounts within an omnibus account) likewise are in the name of the global custodian. In neither case does the U.S. client have any ability to access the subaccount. Moreover, even if the account is registered in the U.S. client's name, rather than merely for the benefit of the client, the U.S. client has no access to the account. Indeed, because of the contractual

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[2] SWIFT is the international system established by the Society for Worldwide Interbank Financial Telecommunication by which custodians and subcustodians communicate with each other regarding asset movement instructions.

[3] 31 CFR §1010.350(e)(1).

[4] 76 Fed. Reg. 10234 (Feb. 24, 2011).

relationship between the global custodian and the subcustodian, the U.S. client has no rights in the account vis-à-vis the subcustodian. The U.S. client's rights are exercised, as they are in a standard omnibus arrangement, only through the U.S. global custodian.

As the purpose of the FBAR regulations is to ensure that records "determined to have a high degree of usefulness in criminal, tax, regulatory, and counter-terrorism matters"[5] are kept and filed, it would appear that the high degree of usefulness is lacking when a U.S. person has no ability to access the foreign account. FBAR filings are not required when a U.S. person cannot access a foreign account because the account is not in a U.S. person's name. The rationale for the final regulation's filing exception – that the U.S. person cannot directly access the account – applies as well to FBO and direct-registration segregated accounts. Indeed, the preamble to the final regulations suggests that the U.S. client maintains these accounts with a U.S. person.[6]

Moreover, it is unclear what benefit would be provided by requiring a U.S. client to file an FBAR for a foreign subcustodial account, in any form, if the client cannot access the account. Information about the account will reside with the U.S. global custodian, which created, manages, and can close the account. If the Government asks the U.S. client to provide information regarding its foreign accounts, the U.S. client will direct the inquiry to the U.S. global custodian; the custodian will provide the information to the Government either directly or indirectly through the U.S. client. Thus, requiring the U.S. client to file an FBAR for foreign subcustodial accounts can be both duplicative and distracting as it potentially directs the Government to a person (the U.S. client) with limited, if any, information about the account and no ability to access it.

For all of the reasons provided above, we request confirmation through a Frequently Asked Question ("FAQ") that a "segregated account" created by a U.S. investment company's U.S. global custodian to hold the investment company's assets in a non-U.S. market is not a foreign financial account of the investment company subject to FBAR reporting by the investment company so long as the investment company cannot access directly the account assets.[7]

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[5] 76 Fed. Reg. 10234 (Feb. 24, 2011). *See also*, 31 U.S.C. § 5311 ("high degree of usefulness").

[6] 76 Fed. Reg. 10234, 10235 (Feb. 24, 2011)("FinCEN wishes to clarify that in this situation, the U.S. customer would not have to file an FBAR with respect to the assets held in the omnibus account and maintained by the global custodian. In this situation, the U.S. customer maintains an account with a financial institution located in the United States.")

[7] We suggest a question and answer such as the following:

> Q: Does a U.S. client have to file an FBAR in the following situation? Specifically, the U.S. client retains a U.S. financial institution, acting as a global custodian, to maintain custody of its assets outside of the U.S. The global custodian, in turn, contracts with a subcustodian in a non-U.S. jurisdiction to hold the assets. The foreign subcustodial account is (a) in the name of the global custodian, (b) in the name of the global custodian for the benefit of ("FBO") the U.S. client, or (c) "directly registered" in the name of the U.S. client without reference to the global custodian. Regardless of the account structure, the contractual agreement between the global custodian

II. Signature Authority – Officer of a Financial Institution

We request clarification that officers of investment companies may utilize the signature authority exception provided by section 1010.350(f)(2)(ii) of the Final Regulations for officers of financial institutions. An officer of an investment company that is required to register with, and is examined extensively by, the SEC pursuant to the Investment Company Act of 1940[8] ("1940 Act") clearly is an officer of a "financial institution" as that term commonly is understood. The BSA and FinCEN support the treatment of a 1940 Act-registered fund as a financial institution. Specifically, the BSA defines a financial institution to include an "investment company."[9] FinCEN has stated, in the preamble to the proposed regulations, that it "believes that [mutual funds and similar pooled funds] fall within the definition of 'investment company,' which is a financial institution under the BSA."[10] Thus, it should be quite clear that an officer of a 1940 Act-registered fund should be covered by the Final Regulations' signature authority reporting exception provided by section 1010.350(f)(2)(ii) for officers of a financial institution.

The preamble to the Final Regulations, however, creates some ambiguity. Specifically, in explaining why the officers and employees of investment advisors are not covered by the signature authority reporting exception provided to employees for "Authorized Service Providers" (*i.e.*, firms that provide services to *"an investment company that is registered with the [SEC]"*), the preamble references a regulatory definition of financial institution that is narrower than the statutory definition.[11] This reference to the narrower regulatory definition has created some confusion regarding the "officer of a financial institution" exception.

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and subcustodian precludes the U.S. client from accessing directly the account created by the subcustodian at the global custodian's direction.

A: The U.S. client would not have to file an FBAR with respect to the non-U.S. account provided that the U.S. client cannot access directly the foreign subcustodial account. In all three situations, the U.S. client maintains an account with a financial institution located in the United States and the specific custodial arrangement does not permit the U.S. client to access directly the foreign holdings maintained at the foreign institution.

[8] 15 U.S.C. §§ 80a-1 *et seq.*

[9] 31 U.S.C. § 5312(a)(2)(I).

[10] 75 Fed. Reg. 8844, 8846 (Feb. 26, 2010).

[11] 76 Fed. Reg. 10234, 10241 (Feb. 24, 2011)(referencing 31 C.F.R. 103.11(n)). Under section 103.11(n), "financial institution" is defined as each agent, agency, branch, or office within the United States of any person doing business, whether or not on a regular basis or as an organized business concern, in one or more of the following capacities: (1) a bank (except bank credit card systems); (2) a broker or dealer in securities; (3) a money services business; (4) a telegraph company; (5) a casino; (6) a card club; (7) a person subject to supervision by any state or federal bank supervisory authority; (8) a futures commission merchant; and (9) an introducing broker in commodities.

No policy rationale of which we are aware would support excluding from the definition of an "investment company" treated as a "financial institution" an investment company registered with, and examined extensively by, the SEC pursuant to the Investment Company Act of 1940. To eliminate the ambiguity created by the preamble to the Final Regulations, we request confirmation of this point, such as through an FAQ.[12]

III. Signature Authority – Officers and Employees of Parents with U.S. and Foreign Subsidiaries

The Institute requests clarification that an officer or employee of a U.S. parent company that is either a financial institution or publicly traded has no FBAR reporting obligation for any foreign account of a domestic or foreign subsidiary of the parent for which the individual has signature authority (so long as he or she has no financial interest in the account). The clarification is requested because of confusion regarding subsidiary accounts that also are treated as a parent company's accounts and, as such, are reportable financial interests of the parent.[13]

The signature authority exception for officers and employees of financial institutions and publicly-traded corporations[14] presumably is provided because the Government is satisfied that these institutions will meet their FBAR reporting obligations. Consequently, duplicative reporting by officers and employees would not provide the "high degree of usefulness" required by the BSA.[15]

Once the Government has determined, as it has, that requiring the parent's officers and employees to file signature authority FBAR reports for the parent's accounts would *not* meet the high degree of usefulness standard, it is unclear how requiring reports by these *same* individuals for these *same* accounts, albeit in the name of the subsidiary, *could* meet the BSA's reporting standard. Perhaps

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[12] We suggest a question and answer such as the following:

> Q: Are officers of investment companies registered with the SEC under the Investment Company Act of 1940 eligible for the reporting exception under section 1010.350(f)(2)(ii) provided for officers and employees of "financial institutions"?
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> A: Yes. Investment companies registered with the SEC under the Investment Company Act of 1940 are "financial institutions" for purposes of section 1010.350(f)(2)(ii).

[13] Pursuant to 31 CFR §1010.350(e)(2)(ii), the parent has a financial interest in every foreign financial account for which the owner of record or holder of legal title is a subsidiary, domestic or foreign, of the parent. As the FBAR reporting obligation is tied to a U.S. person's "financial interest," 31 CFR §1010.350(a), it seems clear that the parent must report all foreign financial accounts of its subsidiaries.

[14] 31 CFR §1010.350(f)(2)(ii) and (iv).

[15] *See*, 31 U.S.C. § 5311. *See also*, 76 Fed. Reg. 10234 (Feb. 24, 2011).

this "no reporting" result is clear to some; the preamble to the Final Regulations suggests quite strongly that this result is not clear to all.[16] Because of ongoing uncertainty, however, we request a frequently asked question that provides expressly that signature authority reporting is not required in these situations.[17]

IV. Signature Authority – Officers and Employees of Subsidiaries With Respect to Accounts of the Parent or Other Subsidiaries

The Institute submits that officers and employees of a subsidiary, the parent of which is a financial institution or publicly traded, should receive the same signature authority reporting exception provided to officers and employees of the parent with respect to *all* of the parent's financial interests. It is unclear how information regarding the signature authority of these individuals is *not* useful if the accounts are in the subsidiary's name but *is* useful if the accounts instead are in the parent's name or in the name of another subsidiary. In *every* case, the parent will be required to report its financial interest in every account over which every individual that it employs directly or through a subsidiary has signature authority.

Strong business reasons dictate in which enterprise (parent or subsidiary) within large corporations that various individuals are employed. In many cases, employees of one subsidiary will provide services (including signature authority) to other subsidiaries or the parent itself. These strong business reasons, however, appear to carry with them substantial FBAR reporting obligations with little, if any, practical benefit since the parent in all cases will be required to report its financial interest in these accounts. Unless the FBAR requirements are modified, firms seeking to minimize redundant and burdensome FBAR reporting for its employees will be required to restructure their enterprises so that any person with signature authority over a subsidiary's accounts also is an employee of that subsidiary. Rather than force this restructuring, we urge a frequently asked question that provides expressly that signature authority reporting is not required in these situations.[18]

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[16] *See*, 76 Fed. Reg. 10234, 10242 (Feb. 24, 2011).

[17] Specifically, we suggest a question and answer such as the following:

> Q: Are officers and employees of a parent company required to report accounts where the owner of record or holder of legal title is a subsidiary, but in which the subsidiary and its parent (pursuant to 31 CFR §1010.350(e)(2)(ii)) each have a financial interest, and over which the officers and employees have signature authority, but in which the individuals have no financial interest?
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> A: No. Because these accounts are reportable by the parent, the parent's officers and employees have no FBAR reporting obligation with respect to their signature authority so long as they have no financial interest in the accounts.

[18] Specifically, we suggest a question and answer such as the following:

V. Signature Authority – Officers and Employees of Foreign Subsidiaries

Officers and employees of foreign subsidiaries of FBAR-compliant U.S. companies should be provided with the signature authority reporting exception that was included in the instructions to the 2008 version of the FBAR. Reporting was not required, under those instructions, so long as the officer or employee was advised in writing that the parent filed a current report that included the account over which the individual had signature authority.[19]

The Final Regulations provide a comparable reporting exception for officers and employees of a U.S. subsidiary of a U.S. entity so long as the U.S. subsidiary is named in a consolidated FBAR report of the parent. The purpose of this exception presumably is to prevent redundant reporting when the FBAR instructions require reporting of the subsidiary's account.

The preamble to the Final Regulations provides, in footnote 17, that the reporting exception for officers and employees of a foreign subsidiary was not included "in light of the broader set of changes made with respect to the signature authority obligation."[20] This language suggests that other changes address the duplicative reporting prevented by the instructions to the 2008 FBAR. In fact, while many of the changes made by the Final Regulations reduce duplicative reporting that is not useful in criminal, tax, regulatory, and counter-terrorism matters, duplicative reporting still will occur with respect to the accounts of a foreign subsidiary over which a U.S. person has signature authority.

We urge that an FAQ be issued expanding the signature authority reporting exception so that officers and employees of foreign subsidiaries of U.S. entities, such as U.S. investment company managers, receive the same treatment as their colleagues who are officers or employees of U.S. subsidiaries of the same U.S. parent entities. This exception would be available, as it is for officers and

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> Q: Are officers and employees of a subsidiary company required to report accounts in which a subsidiary's parent has a financial interest, and over which the officers and employees have signature authority, but in which the individuals have no financial interest?
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> A: No. Because these accounts are reportable by the parent, the subsidiary's officers and employees have no FBAR reporting obligation with respect to their signature authority so long as they have no financial interest in the accounts.

[19] The instructions provided specifically that "[a]n officer or employee of a foreign subsidiary more than 50% owned by [a domestic corporation whose equity securities are listed upon any Unites States national stock exchange or which has assets exceeding $10 million and has 500 or more shareholders] need not file this report concerning signature or other authority over the foreign financial account if the employee or officer has no personal financial interest in the account, and he has been advised in writing by the responsible officer of the parent that the parent has filed a current report which includes that account."

[20] 76 Fed. Reg. 10234, 10242 (Feb. 24, 2011).

employees of U.S. subsidiaries, only if the U.S. parent files a consolidated FBAR report[21] that includes the account.[22]

VI. Signature Authority – Bank-Affiliated Service Providers

Officers and employees of bank-affiliated service providers that offer transfer agency and other administrative services to their investment company clients (hereinafter "transfer agent") should be eligible for the signature authority reporting exception provided to officers and employees of "authorized service providers." The Final Regulations' signature authority reporting exceptions for officers and employees do not address specifically officers and employees of bank-affiliated service companies that are not banks but that nevertheless are registered with, and extensively regulated by, governmental bodies that provide the regulatory supervision required for other signature authority exceptions.

The signature authority exception for bank officers and employees apparently does not apply because these individuals are not officers or employees of the bank itself. Instead, these individuals are officers or employees of a non-banking subsidiary of the bank or bank holding company. Because of the non-banking subsidiary's relationship to the bank, however, the non-banking subsidiary is subject to the same oversight by the banking regulators as the bank itself.

The signature authority exception for "authorized service provider" officers and employees apparently does not apply because these individuals are not officers or employees of a company that is registered with the Securities and Exchange Commission ("SEC").[23] Nevertheless, as discussed below, the non-bank affiliate of the bank is regulated by its appropriate Federal functional regulator and examined by the SEC pursuant to a delegation of authority from the banking regulators. Thus, the supervision envisioned by the FBAR Final Regulations is present.

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[21] As noted above, a parent that owns 50 percent of more of a subsidiary is treated as having a financial interest in the subsidiary's accounts. 31 CFR section 1010.350(e)(2)(ii). Thus, presumably, the parent *must* report its own financial interest in the subsidiary's account.

[22] We suggest a question and answer such as the following:

> Q: Are officers and employees of foreign subsidiaries of U.S. entities that make FBAR filings eligible for the reporting exception provided by section 1010.350(f)(2)(iv) provided for employees and officers of an entity with a class of equity securities listed on any U.S. national securities exchange?
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> A: Yes. This reporting exception is available to officers and employees of U.S. and foreign subsidiaries of entities with a class of equity securities (or ADRs) listed on any U.S. national exchange so long as the person has no financial interest in the account.

[23] The Final Regulations define "authorized service provider" as an entity that is registered with and examined by the SEC and that provides services to an investment company registered under the 1940 Act. 31 CFR § 1010.350(f)(2)(iii).

The Securities and Exchange Act of 1934[24] ("1934 Act") clearly envisions that a transfer agent may be registered with an authority other than the SEC. Section 17A(c)(1) of the 1934 Act provides that in order for a transfer agent to qualify to perform transfer agent functions, the transfer agent must register with its "appropriate regulatory authority." In the case of a national bank, or a subsidiary of any such bank, the "appropriate regulatory authority" is the Comptroller of the Currency.[25]

Registration with the Office of the Comptroller of the Currency ("OCC") entails the same regulatory requirements as registration with the SEC. The OCC conducts routine examinations of banks and bank-chain affiliates. In addition, bank-chain-affiliated transfer agent functions, as defined under the 1934 Act, are subject to SEC inspection under delegated authority. Furthermore, investment companies that receive transfer agency and fund administration services from a bank, or non-bank affiliate, are subject to SEC examination and are required to adopt and implement written compliance policies and procedures that provide for the compliance oversight of certain fund service providers, including their administrator and transfer agent. These investment companies must appoint a Chief Compliance Officer to administer the investment company's compliance policies and procedures under the Federal Securities Laws, defined to include the Bank Secrecy Act;[26] these requirements often are referred to as "Rule 38a-1 Compliance Programs."

We request that an FAQ be issued that addresses the apparent inability of officers and employees of bank-affiliated investment company service providers to qualify for the signature authority reporting exceptions provided to officers and employees of banks and authorized service providers. The FAQ simply could interpret the authorized service provider exception as follows. Specifically, an officer or employee of a bank-affiliated investment company service provider that offers transfer agency or other administrative services would be eligible for the authorized service provider exception so long as (1) the service provider is registered with an appropriate regulatory authority, (2) the service provider is subject to regulation and oversight by its appropriate Federal functional regulator, (3) that regulator is identified in either of the first two signature authority reporting exceptions (*e.g.*, the OCC), and (4) the serviced investment company has adopted and implemented Rule 38a-1 Compliance Programs and is subject to SEC examination.[27] This requested change will

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[24] 15 U.S.C. §§ 78a *et seq.*

[25] 15 U.S.C. § 78c(a)(34)(B)(i).

[26] 17 CFR § 270.38a-1.

[27] We suggest a question and answer such as the following:

> Q: Are officers and employees of bank-affiliated investment company service providers eligible for the reporting exception under section 1010.350(f)(2)(iii) provided for officers and employees of "authorized service providers"?

provide comparable treatment for service providers (whether affiliated with banks or not) that are registered with either the OCC or the SEC.

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If you have any questions or concerns regarding our comments, we would be happy to discuss these issues with you further. Please contact Keith Lawson (at 202/326-5832 or lawson@ici.org) or me (at 202/326-5876 or pinank.desai@ici.org) if we can provide additional information.

Sincerely,

/s/ Pinank K. Desai

Pinank K. Desai
Assistant Counsel – Tax Law

cc: Samuel Berman
Mark E. Cottrell
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Emily M. Lesniak
Robert Zack

A: Yes. An officer or employee of a bank-affiliated investment company service provider that offers transfer agency or other administrative services is eligible for the authorized service provider exception so long as (1) the service provider is registered with an appropriate regulatory authority, (2) the service provider is subject to regulation and oversight by its appropriate Federal functional regulator, (3) that regulator is identified in section 1010.350(f)(2)(i) or (ii), and (4) the serviced investment company has adopted and implemented a Rule 38a-1 Compliance Program and is subject to SEC examination.