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By Electronic Delivery

May 9, 2016

Jennifer Shasky Calvery
Director
Financial Crimes Enforcement Network
P.O. Box 39
Vienna, VA 22183

*RE: Modify FBAR Guidance (RIN 1506–
AB26) to Address Fund-Industry
Concerns*

Dear Director Calvery:

The Investment Company Institute (ICI)¹ urges that the recently-proposed revisions² to the Report of Foreign Bank and Financial Accounts (FBAR)³ filing requirements be modified to resolve ongoing difficulties for the fund industry. The ICI's U.S. investment company (fund) members are registered under the Investment Company Act (the 1940 Act)⁴ and regulated by the Securities and Exchange Commission (SEC). The funds' investment advisors register with, and are regulated by, the SEC pursuant to the Investment Advisers Act of 1940 (the Investment Advisers Act).⁵

¹ The Investment Company Institute (ICI) is a leading, global association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's U.S. fund members manage total assets of \$17.6 trillion and serve more than 90 million U.S. shareholders.

² [81 Fed. Reg. 12614 \(March 10, 2016\)](#).

³ [FinCEN Report 114](#).

⁴ 15 U.S.C. sections 80a-1 *et seq.*

⁵ 15 U.S.C. sections 80b-1 *et seq.*

Our concerns relate to the likelihood that FinCEN will be overwhelmed by essentially worthless FBAR filings unless three different areas are addressed. Specifically, amendments are needed to prevent counterproductive FBAR filings by (1) persons employed by fund managers, (2) individuals with signature authority over 25 or more foreign accounts, and (3) both a fund and its U.S. global custodian with respect to the same account. Our requested guidance is consistent with the FBAR's purposes of thwarting abusive tax schemes and combatting terrorism;⁶ adopting our suggestions will lead to improved compliance.

I. Background

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.

The most common type of fund is the mutual fund.⁷ While differences exist in how investor interests (*e.g.*, shares) in mutual funds and other 1940-Act-registered 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 SEC.

B. *Relationship Between Funds and Their Service Providers*

Because funds 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.

⁶ When strengthening penalties for failures to file a required FBAR, the Senate Finance Committee explained that FBAR reporting is "vitally important to sound tax administration, to combatting terrorism and to preventing the use of abusive tax schemes and scams." See Senate Finance Committee Report, S. Rep. No. 108-192, p. 108 (2004).

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.

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 (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). The custodian’s services generally include safekeeping and accounting for the fund’s assets, settling securities transactions, receiving dividends and interest, providing foreign exchange capabilities, paying fund expenses, reporting failed trades, reporting cash transactions, monitoring corporate actions, and tracing loaned securities.

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 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 provides a regulatory regime for investment advisers, including advisers to funds. This Act requires advisers to satisfy recordkeeping, custodial, reporting and other regulatory responsibilities.⁸

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

⁸ 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.

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 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 back-office 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. General Concerns with the Proposed Revisions to Regulations

We have several concerns with the proposed revisions to the FBAR filing requirements. Our first general concern is that it is unclear whether the intended "expansion and clarification" of the reporting exemptions for certain U.S. persons with signature or other authority (hereinafter "signature authority") over foreign financial accounts⁹ resolves the concerns that we have raised for several years.¹⁰ Specifically, it is not clear whether the phrases "*agent*" and "same corporate *or other business structure*" are intended to encompass fully both the authorized service provider (ASP) exemption included at our request¹¹ in 31 CFR 1010.350(f)(2)(iii) and the additional issues (such as the "brother-sister entity issue") that we have raised. We recommend, as discussed below, that the scope of these phrases be clarified. Alternatively, this reporting exemption could be added as a new "catch-all" exemption following those provided already by 31 CFR 1010.350(f)(2)(i) through (v).

Our second general concern is that the elimination of the limited reporting exemption for persons with a financial interest in or signatory authority over 25 or more foreign financial accounts will lead to extensive reporting that will make it harder, rather than easier, to thwart abusive tax schemes and combat terrorism. FinCEN already has the ability to require reporting of every such account; mandating "data dumps," however, seems counterproductive.

Finally, a clarification that we understood has been provided orally – regarding the filing responsibilities when a fund's foreign investments are held through a global custodian – is not

⁹ 81 Fed. Reg. 12614 at 12615.

¹⁰ See ICI letter to James Freis and Jamal El-Hindi, dated January 15, 2009; ICI letter to Clarissa Potter, dated July 15, 2009; ICI letter to William Wilkins and Michael Mundaca, dated September 30, 2009; ICI letter to James Freis, dated April 27, 2010; ICI letter to James Freis, dated May 23, 2011; ICI letter to James Freis, dated June 9, 2011; and ICI letter to William Wilkins and James Freis, dated August 31, 2011.

¹¹ See ICI letter to James Freis and Jamal El-Hindi, dated January 15, 2009, at page 7.

provided expressly in the revised proposed regulations. We recommend guidance clarifying, in this situation, FBAR reporting would be provided only by the global custodian.

III. Fund Industry Issues for Persons with Only Signature Authority over a Foreign Account

Background

FinCEN and the fund industry both benefit from a robust exemption from FBAR filing for persons who only have signature authority over a fund's foreign accounts. Given the extensive regulation to which funds and their service providers are subject under the 1940 Act and the Investment Advisers Act, FBAR filings by these persons would provide FinCEN only with "clutter;" no meaningful information would be provided.

Two signature authority exemptions presently provide the fund industry with some, but still incomplete, protections from unnecessary filings. The first exemption, in 31 CFR 1010.350(f)(2)(ii), covers an officer or employee of a financial institution that is registered with and examined by the Securities and Exchange Commission with respect to foreign accounts "owned or maintained by" that financial institution. The second exemption, provided by 31 CFR 1010.350(f)(2)(iii) for officers or employees of an Authorized Service Provider (ASP), eliminates any confusion over account "maintenance" by addressing unique aspects of the fund industry. Specifically, the exemption applies to employees of an entity that is registered with and examined by the SEC and that provides services to an investment company registered under the 1940 Act. To qualify for this exemption, the individual's signature authority must be "over a foreign financial account owned or maintained by an investment company that is registered with the [SEC]."

The ASP exemption included in the final regulations, while appreciated, was narrower than requested by the ICI and created the potential for substantial unnecessary signature authority reporting. Subsequently, FinCEN and the IRS issued guidance that attempted to respond to our ongoing concerns. FinCEN Notice 2011-1, as clarified during a conference call with FinCEN staff,¹² purported to expand the ASP exemption to address our concerns about persons employed by affiliated firms not registered directly with the SEC (the "brother-sister entity issue"). FinCEN Notice 2011-2 addressed the additional situation of employees of registered investment advisors who have signature authority over accounts of persons that are not 1940 Act registered products. These expansions, however, never were incorporated into the regulatory exemptions.

The Proposed New Exemption

The proposed new exemption, by eliminating the current exemptions and creating a new "broader" exemption, creates interpretive issues that we submit must be clarified. Specifically, the new

¹² This conversation is described on page 5 of the ICI letter dated August 31, 2011.

exemption provides in part that: “An officer, employee or *agent* of an entity [need not report accounts over which the person has only signature authority] if . . . the account is required to be reported . . . by the entity or any other entity within the same corporate or *other business structure* (emphasis added).”

The preamble provides that the term “agent” is intended “to incorporate entities and individuals, such as [ASPs] and their employees, within the scope of the proposed exemption.” The scope of the term “other business structure,” however, is less clear. The preamble mentions only parent/subsidiary issues. No guidance is provided regarding whether the various “business structure” issues we’ve raised previously, including those covered by the 2011 FinCEN Notices, are covered by the new exemption.

Proposal

We recommend a signature authority reporting exemption that addresses all of the fund industry’s FBAR reporting concerns. The most comprehensive approach would be to retain all five existing exemptions, add the new “broader” exemption as a sixth exemption, and then issue guidance clarifying the scope of the “other business structure” element. This clarifying guidance effectively would incorporate, among other things, the relief provided by FinCEN Notices 2011-1 and 2011-2.

Thus, under our proposal, the term “other business structure” would include both affiliates of firms that are registered with and regulated by the SEC and accounts of investment products that are not registered under the 1940 Act. The rationale for this recommendation is explained in detail in our 2009, 2010, and 2011 letters. In sum, individuals with signature authority over a regulated fund are subject to strict controls, whether they work for a management company subsidiary that is registered with the SEC or a related subsidiary (such as a service company) or other service provider that is not so registered. Moreover, the same controls apply to other domestic (non-1940 Act-registered) investment products offered by the same firms. Finally, firms also apply these stringent controls to non-U.S. investment products (such as UCITS funds)¹³ offered by European affiliates over which U.S. persons have signature authority. Hence, FBAR’s purposes of thwarting abusive tax schemes and combating terrorism are not served by requiring duplicative reporting in any of these situations.

The guidance issued by FinCEN effectively recognized that the issues addressed by the ASP exemption (such as eliminating redundant filings) arise equally in all of the situations described above. Moreover, the requirement that the employee with signature authority work for an SEC-registered firm is inconsistent with the general exception for employees. Because of the extensive securities law regulation of funds under the 1940 Act, the activities of employees of fund service providers are more highly regulated than the activities of employees who benefit from the general employee exception.

¹³ UCITS is the acronym for the European Union Directive on Undertakings for Collective Investment in Transferable Securities. UCITS are the European equivalent of U.S. mutual funds.

FinCEN has recognized in the anti-money laundering (“AML”) context, as noted in our 2010 comments, that regulated funds conduct their operations through service providers that may not be registered with a federal regulator.¹⁴ Thus, whether or not the service provider is itself regulated by the SEC, the service provider has consented to federal examination for purposes of the AML program and the fund remains responsible for compliance with the Bank Secrecy Act (BSA).

Finally, the controls over individuals with signature authority over a regulated fund are identical, in all relevant respects, whether the person is employed by a subsidiary of the fund manager that is registered with the SEC or by a related subsidiary (such as a service company) that is not so registered. In both situations, the extensive securities laws applicable to the regulated fund’s assets adequately safeguard the assets from being used for improper purposes. In addition to the custody requirements over a regulated fund’s assets (which include cash received and disbursed), the funds must satisfy the U.S. securities laws that govern the investment of the fund’s assets in conformance with its prospectus. Similarly, the BSA requirement that a service provider to a mutual fund agree to federal inspection and the fund’s obligation to ensure BSA compliance are exactly the same whether or not the service provider is registered with the SEC.

IV. Retain the Exemption for 25 or More Foreign Accounts

Background

The existing reporting exemptions (the “special rules exceptions”) in 31 CFR 1010.350(g)(1) and (2) for persons with financial interests in or signature authority over 25 or more foreign accounts are entirely consistent with FBAR’s goals. Because FinCEN has an absolute right to receive upon request all relevant information, including the extraordinarily-large filings of highly-regulated foreign accounts, this exemption allows FinCEN to focus more effectively on potentially-problematic situations. Annual detailed reporting of these accounts would not provide data with a high degree of usefulness.

Proposal

We urge that the special rules exceptions be maintained for entities (and their employees) that are subject to extensive regulation under regimes such as the 1940 Act, the Advisers Act, and the BSA. These exceptions also should apply to all of the foreign accounts a highly-regulated U.S. global custodian maintains for its highly-regulated fund clients. Requiring this reporting would not add appreciable value. Moreover, FinCEN and the IRS, in all cases, have access to detailed information from all such regulated entities upon request.

¹⁴ 67 Fed. Reg. 21117, 21119 (April 29, 2002).

Any “gaps” arising from the existing simplified filing procedures should be addressed through targeted changes and/or specific requests for supplemental information rather than through wholesale duplicative reporting and/or voluminous and perhaps impenetrable filings. For example, if FinCEN is concerned that unregulated individuals or entities are able to access the special rules exceptions by creating a significant number of foreign accounts, then the 25 or more account exemption should be repealed only with respect to such unregulated entities and individuals.

V. Eliminate Duplicative Reporting of Foreign Accounts Held by a Global Custodian

Background

The foreign assets of U.S. funds, as noted above, are held by a U.S. global custodian that typically has contractual arrangements with local subcustodians in each foreign jurisdiction. U.S. funds have no contractual relationship with the local subcustodian that actually maintains the foreign account. 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,” (together with FBO segregated accounts, “segregated accounts”) in which the account is titled in the client’s name.

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 segregated account, or a direct-registration segregated account. Even when 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,¹⁵ which is the globally-recognized mechanism for communicating and effecting financial instructions between custodial banks, likewise effectively precludes funds 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 fund, 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

¹⁵ 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.

instructions be SWIFT communications directly from the global custodian. For these reasons, the fund 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.

Proposal

The existing guidance regarding reporting by global custodians should be clarified and expanded to ensure that foreign accounts held by a fund's U.S. global custodian are reportable only by such U.S. global custodian and not by the fund or the other service providers to such fund. Existing guidance¹⁶ clarifies that an omnibus account held at a subcustodian that is in the name of the U.S. global custodian is not reportable by the U.S. global custodian's U.S. customers; in this situation, the global custodian has the reporting responsibility as the "owner of record or [the person with] legal title."¹⁷

Informal, non-binding guidance that was provided orally by IRS officials goes further. Specifically, many industry participants understand that foreign accounts held by a fund's U.S. global custodian are reportable only by such U.S. global custodian regardless of how the foreign accounts are registered.¹⁸ This informal guidance is appropriate as, under industry practice, U.S. funds have no contractual relationship with the local subcustodian in the foreign jurisdiction that actually maintains the foreign account. All instructions regarding these accounts are issued to the local subcustodian by the U.S. global custodian. We urge that this guidance be included in any revised regulations.

The guidance we request for segregated accounts is consistent with the preamble to the Final Regulations; the preamble 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."¹⁹ Moreover, the rationale for the final regulation's filing exemption for an account not in the client's name – that the U.S. person cannot access the foreign account directly –

¹⁶ 76 Fed. Reg. 10234 (Feb. 24, 2011).

¹⁷ 31 CFR §1010.350(e)(1).

¹⁸ The industry's understanding also is reflected in the ICI's May 23, 2011 request for a Frequently Asked Question clarifying "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."

¹⁹ 76 Fed. Reg. 10234, 10235.

applies as well to segregated accounts. Indeed, the preamble to the final regulations suggests that the U.S. client maintains these accounts with a U.S. person.²⁰

Finally, 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. We submit that the U.S. global custodian should file an FBAR for all of its subcustodial accounts because, in all cases, the subaccount either will be in the U.S. global custodian's name or the custodian will maintain the account (through the signature authority that its employees have over the account). Information about the account will reside with the U.S. global custodian that created, manages, and can close the account. If the Government asks the fund to provide information regarding the subcustodial account, the fund 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 fund.

For all of the reasons provided above, we request formal confirmation that a segregated account created by a fund'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 fund subject to FBAR reporting by the investment company so long as the fund cannot access directly the account assets. Official guidance confirming this position will provide U.S. global custodians and their customers with certainty regarding their FBAR filings and prevent the possibility of duplicative filings.

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Once again, we appreciate FinCEN's attention to the fund industry's specific FBAR concerns. Our recommendations, we submit, will enhance the value of the information collected by FinCEN and will make FBAR reporting more administrable. Please feel free to contact my colleague Ryan Lovin (at ryan.lovin@ici.org or 202-326-5826) or me (at lawson@ici.org or 202-326-5832) at your convenience if we can provide you with any additional information.

Sincerely,

/s/

Keith Lawson

Deputy General Counsel – Tax Law

cc: Jamal El-Hindi
regcomments@fincen.gov (attn: RIN 1506-AB26 - Docket Number FINCEN--2014-0006)

²⁰ 76 Fed. Reg. 10234, 10235. "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."