



INVESTMENT FUNDS UPDATE

Reporting U.S. Ownership of Foreign Securities on Treasury's TIC Form SHC

Certain U.S.-resident custodians and end-investors, including investment funds, that have holdings of foreign securities will be required to file a Report of U.S. Ownership of Foreign Securities, Including Selected Money Market Instruments ("Form SHC") by March 2, 2012, to reflect their holdings as of December 31, 2011. Form SHC is a benchmark survey conducted every five years to collect data on U.S. ownership of foreign securities as part of the Treasury International Capital ("TIC") reporting system. The reported information is used by the U.S. government in computing U.S. balance of payments accounts and international investment positions, and formulating international economic and financial policies. This update provides an overview of Form SHC reporting requirements for U.S.-resident entities that may need to prepare and file the report.

Parties Subject to Reporting

Form SHC is mandatory for all U.S.-resident custodians and end-investors that (1) have holdings in foreign securities that meet the reporting thresholds as outlined below or (2) are notified by the Federal Reserve Bank of New York ("FRBNY"), as fiscal agent for the U.S. Treasury Department, that they are required to submit the Form SHC. For purposes of this form, "U.S. resident" is defined as any individual, corporation or other entity incorporated or legally established in the United States, including branches, subsidiaries and affiliates of foreign entities located in the United States.

U.S.-resident custodians must report both foreign portfolio securities held in safekeeping for other U.S. residents and invested for their own portfolios. U.S.-resident end-investors must report all foreign securities invested for their own portfolios or for the portfolios of U.S.-resident clients. End-investors are entities such as (but not limited to): financial and non-financial organizations; managers of private and public pension funds; managers/sponsors of mutual funds, hedge funds, private equity companies, and other pooled funds and private investment vehicles; insurance companies; foundations; universities; trusts and estates; and funds and similar entities that own shares or units of, or other portfolio equity interests in, a foreign related or non-related entity.

The form consists of three reporting schedules.

- Schedule 1 must be filed by a reporter that (a) meets the reporting thresholds for filing a Schedule 2 or 3, or (b) is notified of its reporting obligation by the FRBNY even if it does not meet the reporting thresholds for filing a Schedule 2 or 3. This schedule requires the reporter's identification and contact information, summary of data (if any) reported on Schedule 2 and/or Schedule 3, and certifying information.

- Schedule 2 must be filed by a reporter if the total fair value of foreign securities whose safekeeping it manages for itself and other U.S. residents, and whose safekeeping the reporter has entrusted directly to foreign-resident custodians or U.S.- or foreign-resident central securities depositories, is \$100 million or more. This schedule requires detailed information regarding the foreign securities.
- Schedule 3 must be filed by a reporter if the total fair value of the reporter's foreign securities that are entrusted to an unaffiliated U.S.-resident custodian (other than a U.S.-resident central securities depository) is \$100 million or more. This schedule requires summary amounts of the entrusted foreign securities.

Reportable Securities

For purposes of Form SHC, a security is foreign if it is issued by an entity that is incorporated or otherwise legally organized or licensed (such as branches) under the laws of a foreign country. Reportable foreign securities include most types of equities, short-term debt securities (including selected money market instruments such as negotiable CDs and commercial paper), and long-term debt securities. Asset-backed securities are reportable but separated from other debt securities. Securities issued by international or regional organizations, such as the World Bank, are also reportable regardless of where the organization is physically located.

Securities expressly excluded from the Form SHC include derivative contracts, loans and loan participations, letters of credit, bank deposits (except for negotiable CDs), securities temporarily acquired under reverse repurchase/borrowing/lending arrangements and the underlying securities of depositary receipts.

Form SHC collects information on U.S. holdings of foreign portfolio securities. Direct investment relationships where there is ownership or control of 10% or more of the voting stock of a foreign company,¹ purchases of foreign real estate and general partnership ownership interests are generally not subject to reporting. Limited partnership interests, on the other hand, are not considered to have voting rights and are reportable on Form SHC regardless of ownership percentage.

Of particular relevance to U.S. investment advisers and managers, foreign securities owned by U.S.-resident funds are reportable and should be classified as equity, debt or asset-backed securities. Investments in shares of, or other equity interests in, foreign funds should be reported as equity, regardless of the types of securities held by the fund itself. Any investment between the investment manager or other entity that formed the funds (as a general partner) and the entities that it creates should, however, be excluded from Form SHC.

Consolidation Rules

The reporter should consolidate all reportable securities held or managed by all U.S.-resident parts of the organization, including all U.S.-resident branches, offices and subsidiaries. The top U.S. resident parent entity in each organization should ensure that its report covers all applicable entities within the organization. A U.S. investment adviser or manager is generally considered an end-investor and would include its own portfolio investments, and those of its U.S.-resident clients including U.S. fund clients. By way of example, in a master-feeder fund structure set up by a U.S. investment manager, the investment that a U.S. feeder fund has in a foreign master fund should be reported by the U.S. investment manager on behalf of the U.S. feeder fund. In a master-feeder fund structure set up by a foreign investment manager, the investment that a U.S. feeder fund has in a foreign master fund should be reported by the U.S. feeder fund.

¹ A "direct investment relationship" exists when a U.S. resident owns, directly or indirectly, 10% or more of the voting equity securities of a foreign business. Direct investments are not reported on the Form SHC, but instead reported to the U.S. Commerce Department's Bureau of Economic Analysis. However, if one of the entities is a depository institution, a securities firm, a bank holding company or financial holding company, then inter-company holdings are not considered to be a direct investment and are reportable on the Form SHC.

Accounting and Valuation

All securities should be reported using settlement date accounting. Netting of short positions from long positions is not permitted. Gross long positions should be reported. Securities should be reported at fair value as of December 31, 2011 in accordance with ASC 820 (formerly FAS 157). If a security is not denominated in U.S. dollars, the foreign currency fair value can be converted into U.S. dollars using the spot exchange rate as of December 31, 2011.

Submission of Reports

Form SHC is required approximately every 5 years. The next Form SHC must report data as of December 31, 2011 and be submitted to the FRBNY by March 2, 2012. There are specific rules in the form instructions as to whether each Schedule may be submitted on paper or electronically. All data used to create the report must be retained for 3 years from date of submission. The very largest U.S.-resident custodians and end-investors will also be required by the FRBNY to file reports on the annual TIC Form SHCA.

Form SHC and accompanying instructions are available at: <http://www.treasury.gov/resource-center/data-chart-center/tic/Documents/shc2011in.pdf>.

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If you have any questions regarding this update or require more information, please contact Connie M. Friesen at cfriesen@sidley.com or (212) 839-5507 or the Sidley lawyer with whom you regularly work.

The Investment Funds Practice of Sidley Austin LLP

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