

CLIENT MEMORANDUM

BEA Implementing Changes to Certain Reporting Requirements for Direct Investments by Private Fund Managers

January 3, 2017

AUTHORS

Russell L. Smith | **Scott A. Arenare** | **Anne C. Choe** | **Brook Sutton** | **Arthur C. Damoulakis**

The U.S. Commerce Department's Bureau of Economic Analysis (the "BEA"), in cooperation with the U.S. Treasury Department (the "Treasury"), is currently implementing changes that may decrease the information that certain private fund managers must report in connection with the BEA's surveys regarding direct investments. Those surveys consist of:

- the BEA's surveys regarding U.S. direct investment abroad: (1) the BE-577, Quarterly Survey of U.S. Direct Investment Abroad; (2) the BE-11, Annual Survey of U.S. Direct Investment Abroad; and (3) the BE-10, Benchmark Survey of U.S. Direct Investment Abroad; and
- the BEA's surveys regarding foreign direct investment in the United States: (1) the BE-605, Quarterly Survey of Foreign Direct Investment in the United States; (2) the BE-15, Annual Survey of Foreign Direct Investment in the United States; (3) the BE-12, Benchmark Survey of Foreign Direct Investment in the United States; and (4) the BE-13, Survey of New Foreign Direct Investment in the United States (collectively, the "BEA direct investment surveys").

The BEA expects that the changes will primarily affect hedge fund managers by potentially removing the managers from the BEA reporting regime and shifting their reporting requirements to the Treasury International Capital ("TIC") reporting regime; private equity managers, however, are likely to remain subject to the BEA reporting regime.

BEA Implementing Changes to Certain Reporting Requirements for Direct Investments by Private Fund Managers

Continued

The changes will apply to the BEA direct investment surveys conducted on or after January 1, 2017, and the BEA stated that it plans to notify entities potentially affected by the changes in early 2017.

The changes to the BEA direct investment surveys are intended to ensure that the characterization of a private fund investment as a direct investment or a portfolio investment under the BEA and TIC reporting systems aligns with the intent of the investment. As a result of the changes, private fund managers of cross-border funds that invest only in other private funds, in holding companies, or in less than 10% of the voting interest of an operating company may be required to report under the TIC reporting system rather than on the BEA direct investment surveys.

The changes exempt a cross-border investment by an entity in a private fund from the reporting requirements of the BEA direct investment surveys if the entity does not own through the fund at least 10% of the voting interest of an operating company (*i.e.*, a company that is not another private fund or a holding company). The BEA has also amended the BE-13 survey to, among other things, combine Form BE-13A, Report for Acquisition of a U.S. Business Enterprise That Remains a Separate Entity, and Form BE-13C, Report for Acquisition of a U.S. Business Enterprise That is Merged With an Existing U.S. Affiliate, into one form and discontinue the use of Form BE-13C.

Private Fund Reporting Changes

Under the current reporting schemes of the BEA and TIC, a cross-border investment in which an entity acquires or controls, directly or indirectly, at least 10% of the voting interest of a private fund is considered a “direct investment” and is reportable on the BEA direct investment surveys. A cross-border investment below the 10% threshold is characterized as a “portfolio investment” and is reportable on the applicable TIC surveys. Under the BEA and TIC reporting regimes, a general partner is generally considered to control 100% of the voting interest in a limited partnership, and a managing member is generally considered to control 100% of the voting interest in a limited liability company. As a result, a private fund manager (or the manager’s affiliate) that serves as the general partner or managing member of its cross-border funds is generally considered to control 100% of the voting interest of each of its cross-border funds. Such characterization has resulted in many private fund managers currently being deemed to have a direct investment in their cross-border funds, thereby subjecting the managers to the BEA reporting regime rather than the TIC reporting regime.

The changes will exempt from the definition of “direct investment” for purposes of the BEA direct investment surveys an entity’s cross-border investment in a private fund if the entity does not own through the fund at least 10% of the voting interest of an operating company. Fund investments exempted from the BEA’s definition of “direct investment” will be reclassified as “portfolio investments” and subject to the TIC reporting requirements. The changes will not affect direct or indirect cross-border investments by an entity in an operating company, as such investments remain reportable under the BEA direct investment surveys if the entity acquires or controls, directly or indirectly, at least 10% of the voting interest of the operating company. Accordingly, a cross-border investment in a hedge fund that invests in portfolio investments (*e.g.*, stocks, bonds, or derivatives) without acquiring or controlling at least 10% of the voting interest of an operating company will now fall under the TIC reporting regime, whereas, a cross-border investment in a private equity fund that invests in

BEA Implementing Changes to Certain Reporting Requirements for Direct Investments by Private Fund Managers

Continued

operating companies and holds at least 10% of the voting interest of an operating company will remain subject to the BEA reporting regime.

BE-13 Survey Changes

As part of the changes, the BEA incorporated Form BE-13C into Form BE-13A and discontinued Form BE-13C. A U.S. entity now will be required to file a BE-13A survey form when (1) a non-U.S. entity acquires a voting interest (directly or indirectly through an existing U.S. affiliate) in the U.S. entity (including segments, operating units, or real estate); (2) the total cost of the acquisition is greater than \$3 million; and (3) the acquisition results in the non-U.S. entity now owning at least 10% of the voting interest (directly or indirectly through an existing U.S. affiliate) in the acquired U.S. entity.

The BEA also amended Form BE-13B, Report for Establishment of a New U.S. Business Enterprise, so that a U.S. business enterprise will no longer be required to file a BE-13B survey form when a non-U.S. entity (or an existing U.S. affiliate of a non-U.S. entity) establishes a new U.S. entity to facilitate a single U.S. acquisition that takes place within 30 days. The U.S. business enterprise will instead consolidate the new U.S. entity with the acquired U.S. entity and submit a single BE-13A survey form.

If you have any questions regarding this memorandum, please contact Russell L. Smith (202-303-1116, rsmith@willkie.com), Scott A. Arenare (212-728-8252, sarenare@willkie.com), Anne C. Choe (202-303-1285, achoe@willkie.com), Brook Sutton (212-728-8733, bsutton@willkie.com), Arthur C. Damoulakis (202-303-1177, adamoulakis@willkie.com) or the Willkie attorney with whom you regularly work.

Willkie Farr & Gallagher LLP is an international law firm with offices in New York, Washington, Houston, Paris, London, Frankfurt, Brussels, Milan and Rome. The firm is headquartered at 787 Seventh Avenue, New York, NY 10019-6099. Our telephone number is (212) 728-8000 and our fax number is (212) 728-8111. Our website is located at www.willkie.com.

January 3, 2017

Copyright © 2017 Willkie Farr & Gallagher LLP.

This memorandum is provided by Willkie Farr & Gallagher LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This memorandum may be considered advertising under applicable state laws.