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Tax Treaties, Transfer Pricing and Financial Transactions Division
Organisation for Economic Co-operation and Development
Centre for Tax Policy and Administration
2 rue André-Pascal
75775, Paris, Cedex 16, France
Submitted by email: tfde@oecd.org

RE: *Clarifications to Asset Manager Exclusion to Pillar One Amount A*

Dear Secretariat Team,

The Investment Company Institute (ICI)[1] supports strongly the robust Pillar One Amount A exclusion for regulated financial services (RFS) institutions that are asset managers. The test provided in the Progress Report on Amount A of Pillar One ("Progress Report") addresses our significant concern[2] with the asset manager exclusion.[3] To ensure tax certainty—for both asset managers and tax authorities—the "licensed" requirement should be expanded to include managers that are "authorized or registered." We also explain why the Commentary should focus on the IOSCO principles as ensuring that asset managers have sufficient substance in the market jurisdiction for tax purposes. A capital requirement, as evidenced by the robust securities regime in the United States, is not necessary so long as the IOSCO principles are followed.

[1] The Investment Company Institute (ICI) is the leading association representing regulated investment funds. ICI's mission is to strengthen the foundation of the asset management industry for the ultimate benefit of the long-term individual investor. Its members include mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and UCITS and similar funds offered to investors in Europe, Asia and other jurisdictions. Its members manage total assets of $28.1 trillion in the United States, serving more than 100 million investors, and an additional $9.3 trillion in assets outside the United States. ICI has offices in Washington, DC, Brussels, London, and Hong Kong and carries out its international work through ICI Global.

[2] *See* ICI Letter to OECD Secretariat, May 20, 2022.

[3] Schedule C, section 20, paragraph 2, defines "asset manager" for purposes of the regulated financial services exclusion as a group entity that, among other things, is "licensed to carry on asset management as a business" and "is subject to regulation reflecting the Objectives and Principles of Securities Regulation as adopted by the IOSCO [International Organization of Securities Commissions] and the related implementing methodology." Progress Report, page 55.

Strong Support for the Asset Manager Exclusion from Amount A

The RFS exclusion from Amount A is appropriate, as described in our prior submissions, as a matter of both tax policy and tax administration. Financial institutions are required by governments in the jurisdictions in which they operate to develop and maintain compliance systems and procedures to protect clients' assets. Asset managers—because of governments' understandable demand that firms act in the best interest of investors—are subject to extensive regulation. The asset manager exclusion is essential to effective implementation of the RFS exclusion. The asset manager exclusion also is essential to preventing potential competitive disadvantages for those asset managers that do not have banking and/or insurance businesses eligible for the RFS exclusion.

The Appropriate Regulatory Standard for Part (a) of the Asset Manager Definition

The potential for significant tax uncertainty is created by the current requirement in part (a) of the asset manager definition that a manager be "licensed" to carry on business.[4] Although governmental permission to conduct certain types of regulated financial services is provided by "licenses,"[5] somewhat different approaches—without practical difference—typically are required for those seeking government approval to operate asset management businesses. Consequently, we urge that the asset manager definition in the RFS exclusion be modified in the Substantive Rules.

Specifically, the robust and effective securities regulatory regimes that apply to asset managers generally are based upon governmental authorization or registration. European law uses "authorized" in, for example, the Undertakings for Collective Investment in Transferable Securities (UCITS) Directive,[6] the Alternative Investment Fund Managers Directive (AIFMD),[7] and the Marketing in Financial Instruments Directive (MiFID).[8] Similarly, in the

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[4] Schedule C, section 20, paragraph 2(a) defines "Asset Manager" to mean a Group Entity "that is licensed to carry on asset management under the law or regulations of the jurisdiction in which the group Entity does that business, or in the case of a Group Entity that does such business in one or more EEA Member States, is licensed by a competent authority to carry on such business in an EEA Member State." Progress Report, page 55.

[5] In the United States, for example, banking licenses are issued by the Office of the Comptroller of the Currency.

[6] Article 6 of the UCITS Directive provides in part that "Access to the business of management companies shall be subject to prior authorisation to be granted by the competent authorities of the management company's home Member State." *See* page 9.

[7] Article 6 of the AIFM Directive provides in part that "Member States shall ensure that no AIFMs manage AIFs unless they are authorised in accordance with this Directive." *See* page 11.

[8] Article 5 of MiFID provides in part that "Each Member State shall require that the performance of investment services or activities as a regular occupation or business on a professional basis be subject to prior authorisation in accordance with the provisions of this Chapter." *See* page 18.

United States, asset managers are required by the Investment Advisers Act of 1940[9] to "register."

The International Organization of Securities Commissions' (IOSCO's) Objectives and Principles of Securities Regulation[10] (the IOSCO principles), referenced in part (b) of the asset manager definition, likewise do not require "licensing." Principle 24 instead provides that "[t]he regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a collective investment scheme."[11]

To ensure that the RFS exclusion works as intended, the Substantive Rules in part (a) of the asset manager definition should reference "authorized or registered" as well as "licensed." Only a change to the Substantive Rules will prevent tax uncertainty. A less satisfactory alternative, as some tax uncertainty could remain, would be for Commentary to the asset manager definition to state that "licensed," "authorized," and "registered" are equivalents.

The Appropriate Regulatory Standard for Part (b) of the Asset Manager Definition

We support strongly the revised part (b) of the asset manager definition which provides that the appropriate regulatory standard should be based on the IOSCO principles. An appropriately robust regulatory regime for collective investment vehicle (CIV) managers, as provided by IOSCO Principle 24, should include standards governing eligibility to conduct business, governance, organization, and operational conduct. The regulatory regime also should: provide rules for the segregation and protection of client assets (Principle 25); impose disclosure obligations so that CIV investors have information regarding the value of their CIV interests and can make suitability determinations (Principle 26); and ensure that the basis of asset valuation, and the pricing and the redemption of units, is proper and disclosed (Principle 27). These principles ensure that there is sufficient substance in the jurisdictions in which the asset manager's customers reside.

IOSCO's work on appropriate standards for CIV managers dates back to 1995, when the IOSCO Technical Committee published *Principles for the Regulation of Collective Investment Schemes*. In that report, IOSCO first articulated a principle to guide regulation concerning the eligibility of a CIV manager as follows:

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[9] Section 203a of the Investment Advisers Act (*see* page 7) requires registration. This Act authorizes the adviser to manage US registered investment companies (collective investment vehicles under the Investment Company Act of 1940).

[10] Objectives and Principles of Securities Regulation, INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS (May 2017), hereafter "IOSCO Principles."

[11] IOSCO Principles, page 10.

> CIS Principle 3 - "Eligibility to Act as an Operator" - looks at the regulator's role in imposing minimum eligibility standards of conduct that require approval by the regulatory authority prior to commencement of marketing of a CIS, which include:
> • Honesty and Fairness;
> • Capability (i.e. human and technical resources);
> • Diligence and Effectiveness;
> • Operator Specific Powers and Duties (i.e. duty to make decisions as to the investment portfolio structure and administrative procedures); and
> • Compliance (i.e. adherence to strictly defined standards set by the regulatory authority).[12]

These eligibility requirements were discussed by IOSCO, fifteen years later, as follows:

> Because of their extensive (and increasing) use by both individual and institutional investors, the proper regulation of CIS is critical to achieving all of the objectives of securities regulation outlined above. The regulation and supervision of a CIS typically includes not only the scheme itself but also the operator of the scheme. Typically, a CIS operator is the legal entity that has overall responsibility for the management and performance of the functions of the CIS, which may include investment advice and operational services. The IOSCO Principles identify the regulatory components of measuring an entity's eligibility to act as a CIS operator, which include, for example, considering the honesty and integrity of the operator, its competence to carry out its functions, its financial capacity, its specific powers and duties and its internal management procedures. The IOSCO Principles also specify the components of a regulatory program that are necessary to supervise a CIS and its operator. The components identified include, among other things, registration and authorization of a scheme and the ability of the regulator to inspect the CIS operator.[13]

Importantly, IOSCO's principles do not require jurisdictions to measure a CIV manager's eligibility by a capital adequacy standard. This approach is consistent with the nature of asset management, in which CIV managers act as agents, not as principals. A CIV and its investors, not its manager, bear the risk of the CIV's investments. Acting as agent, a CIV manager manages the CIV's portfolio in accord with the CIV's investment objectives and policies as described in the CIV's prospectus. Management fees compensate the manager for managing the CIV as a fiduciary and agent and for providing ongoing services that the CIV needs to operate. The manager does not own the CIV's assets; it may not use those assets to

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[12] Principles for the Regulation of Collective Investment Schemes, IOSCO Technical Committee (July 1995), pages 7-8.

[13] Principles Regarding Cross-Border Supervisory Cooperation, IOSCO Technical Committee (May 2010), page 22, hereafter "Principles Regarding Cross-Border Supervisory Cooperation."

benefit itself or any other CIV. Investment gains and losses experienced by a CIV are solely attributable to that CIV and its investors.

We also support detailed Commentary regarding the asset manager definition, including this revised part (b), to minimize the potential for tax uncertainty. This Commentary—and its consistent application—will be important because of the large number of jurisdictions in which an asset manager may operate.

We believe that it is critically important that the Commentary clearly indicate that the status of a jurisdiction's regulatory regime affects only the revenue arising in that jurisdiction. A jurisdiction should not be able to assert taxing rights over an asset manager operating primarily in jurisdictions (including its "home" jurisdiction) with robust regulatory regimes simply because of a perceived deficiency in one or more other jurisdictions' regimes.

A good starting point for the Commentary guidance is the 2010 IOSCO Final Report entitled *Principles Regarding Cross-Border Supervisory Cooperation* (hereafter the "2010 Report"). Securities regulators, as stated in the first sentence of the Report's Executive Summary, believe that "efficient and effective markets require fair, effective and comprehensive market regulation vigorously implemented and enforced by securities and other market regulators with comprehensive inspection, enforcement and oversight powers and backed by adequate resources and staff expertise."[14]

The supervision of asset managers involves both a "first line of regulation"[15] (an initial authorization/registration/licensing requirement) and continuing oversight requirements such as being subject to inspection and examination. What is essential, as explained in the Report, is that different approaches can be equally acceptable from the perspective of meeting IOSCO's three objectives of securities regulation: protecting investors; ensuring that markets are fair, efficient, and transparent; and reducing systemic risk.

We suggest that the Commentary provide some details regarding the initial authorization process and the ongoing oversight requirements that ensure robust regulation. Given IOSCO's role in developing a global consensus regarding robust securities regulation, the Pillar One Commentary should reference, but not go beyond, what IOSCO has provided. The attached appendix provides additional details regarding IOSCO's guidance and quotes particularly relevant passages.

We also suggest that the Commentary reference the procedures that securities regulators have developed for cross-border supervision. These procedures—designed to ensure adequate

[14] Principles Regarding Cross-Border Supervisory Cooperation, page 3.

[15] Principles Regarding Cross-Border Supervisory Cooperation, page 12.

supervision of firms operating globally—also are discussed in the 2010 Report and described in the attached appendix. These procedures are important because they provide a mechanism through which securities regulators in a market jurisdiction can receive assistance from securities regulators in the asset manager's "home" jurisdiction in ensuring compliance with the market jurisdiction's requirements.

Finally, we suggest that the OECD liaise with IOSCO on developing a "whitelist" of jurisdictions that provide sufficiently robust regulation.[16] Tax certainty will not be achieved if tax authorities in one jurisdiction have significant leeway—without clear guidance—in making determinations about the robustness of any jurisdiction's securities laws.

* * *

The ICI supports strongly the robust Pillar One Amount A exclusion, provided in the Progress Report, for asset managers and other RFS institutions. We also urge that the "licensed" requirement in part (a) of the asset manager definition be expanded to include managers that are "authorized or registered." Finally, the requirements in parts (a) and (b) of the asset manager definition should be developed in the Commentary by referencing details from the 2010 IOSCO Report and adopting the additional suggestions that we have advanced. The changes we propose will help ensure tax certainty for both asset managers and tax authorities.

The ICI appreciates greatly this opportunity to comment on the Progress Report. We would be pleased to respond to any questions you have regarding this submission. Please feel free to contact the undersigned—at lawson@ici.org (1-202-326-5832) or katie.sunderland@ici.org (1-202-326-5826) —at your convenience.

With kind regards,

/s/ Keith Lawson

Keith Lawson
Deputy General Counsel, Tax Law
Investment Company Institute

/s/ Katie Sunderland

Katie Sunderland
Assistant General Counsel, Tax Law
Investment Company Institute

Attachment

[16] The United States, even without capital requirements on asset managers, has a robust regulatory regime that protects fund investors. Certain aspects of the US regulatory scheme—including provisions that address fund operations (such as strict regulation of transactions that raise potential conflicts of interest and valuation of fund portfolios), provide for annual audit by independent accountants, and require fidelity bonding to protect against fraud by employees of mutual funds—mitigate against operational risk. The availability and widespread practice of using insurance to cover operational risk also should be recognized as appropriate alternatives to regulatory capital requirements.

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APPENDIX

IOSCO 2010 Report—Chapter 4 (Supervision of Regulated Entities in a Global Market)

The registration process, as explained in the 2010 Report, "assists a regulator in assessing an applicant's ability to operate in compliance with applicable regulatory requirements. Depending on the type of registrant, registration requirements typically mandate that the registrant provide the regulator with information regarding such things as its planned regulated activities, financial health, corporate governance structure and management."[17]

The supervision, as envisaged in the 2010 Report, "includes review of filed reports, market surveillance, examinations and other mechanisms by which a regulator confirms day-to-day compliance by regulated entities with securities laws, regulations, prudential regulatory requirements, self-regulatory organization (SRO) rules, and internal requirements, even absent suspicion that a violation may have occurred."[18] The Report also notes that this supervision, in some jurisdictions, is performed by third parties.

The 2010 Report also discusses at some length the inspection and examination process—which needs to reflect national considerations.

> There are several types of inspections and examinations that can be part of a comprehensive oversight program, depending on the types of regulated entities involved and the nature of the regulation and oversight regime. Because regulators often lack the resources necessary to frequently inspect or examine the large number of regulated entities within their jurisdiction, risk-identification or risk-assessment methodologies are sometimes used to identify those risks that warrant additional inspection and examination. Such a methodology might include, for example, an internal database for examiners and managers to use to identify and prioritize risks and to recommend regulatory, examination or other actions that could be taken to address or mitigate the risks identified. A regulator may then sort and analyze its risk information to identify potential high-risk areas, prioritize risks for examination attention and allocate program resources. Risk-assessments may also be used for inspection and examination training initiatives to educate examiners about risk details, identifiable focus areas and examination program priorities. Risk information

[17] Principles Regarding Cross-Border Supervisory Cooperation, page 12.

[18] Principles Regarding Cross-Border Supervisory Cooperation, page 12, footnote 5.

> might also be shared with other members of the regulator's staff for their consideration in evaluating policy priorities.[19]

Various different types of examinations also may be employed depending on the specific circumstances of the regulated financial services institution. As provided in the Final Report,

> In accordance with national practice, these types of examination can include: risk-based examinations that seek to determine the extent, scope, and danger of emerging risks; periodic examinations designed to periodically test a regulated entity's compliance with applicable laws and regulations pursuant to a schedule set by the regulator; cause examinations to confirm concerns about violations of the securities laws based on press reports, complaint letters, information provided by other regulators, tips, or other indications of wrongdoing; oversight examinations (in those jurisdictions with SROs) designed primarily to test the quality of the SRO's examinations of its members or test directly SRO members' compliance with applicable securities laws and the SRO's rules; and oversight inspections to examine the SRO's themselves for compliance with relevant laws and rules.[20] [Emphasis in original.]

The 2010 Report also discusses at length the coordination and cooperation that is required between securities regulators to ensure asset managers' compliance with the IOSCO Principles. The regulatory regime in the asset manager's "home" jurisdiction is relevant to this coordination and cooperation.

> Broadly speaking, there are two different scenarios where the cross-border activities of regulated entities call for an enhanced degree of supervisory cooperation and coordination. The nature of the cooperation and coordination, however, may differ under each of the scenarios. The first involves a regulated entity located in one regulator's jurisdiction, but which also has affiliate offices located abroad. In light of the fact that an affiliate's activities may have important implications for a regulated entity, a regulator may need to obtain the assistance of the counterpart charged with oversight of the affiliate in assessing, for example, the affiliate's financial condition, compliance culture or risk profile.
>
> Second, a considerable degree of supervisory cooperation likely will be necessary in situations where a regulated entity provides services in multiple jurisdictions and thus is subject to regulation by multiple regulators. Typically, a regulated entity will be required to register and be subject to the regulation of each jurisdiction in which it

[19] Principles Regarding Cross-Border Supervisory Cooperation, pages 12-13.

[20] Principles Regarding Cross-Border Supervisory Cooperation, page 13, footnote 7.

> operates. Close supervisory cooperation between the regulators charged with overseeing such entities is important, both to avoid placing these regulated entities in situations where they face (unnecessarily) conflicting regulation, but perhaps also to limit duplicated effort and unnecessary costs to both the regulated entities and the regulators involved. They also allow for different approaches to supervision that regulators might take to benefit each other, providing the partner regulators with a second perspective that might shed light on issues that one perspective alone might miss.[21] [footnote omitted]

<u>IOSCO 2010 Report - Chapter 6 (Cross-Border Cooperation in the Supervision of Different Types of Regulated Entities)</u>

The 2010 Report also discusses in detail the procedures by which regulators should coordinate when asset managers operate in multiple jurisdictions. This coordination enhances the degree to which asset managers are subject to robust oversight.

> When considering means to establish and enhance the supervision of globally-active regulated entities, regulators need to evaluate the nature of these entities, how their operations are conducted across borders, and the degree to which information that the regulator requires domestically is available for entities with operations abroad. Since these entities, regardless of their legal structures, typically are financially and legally exposed to other markets in ways that purely domestic entities are not, regulators need to keep in mind how these entities are regulated in the other jurisdictions in which they operate, the existence of any regulatory differences with these jurisdictions, and the nature of how they are supervised abroad so that they can carry out their regulatory mandates. Generally speaking (and absent an arrangement whereby one regulator relies on the oversight provided by a "home" regulator with regard to entities based in the home regulator's market), when a foreign-based market participant registers to provide services in a jurisdiction, the securities regulator will require the registrant to provide it with information regardless of where that information may reside. Access to information and confirmation of its accuracy, however, may require the assistance of an overseas regulator and, for a variety of reasons discussed more fully below, effectively analyzing these cross-border regulatory factors requires a degree of supervisory cooperation and information sharing that may exceed what has been typical in the past.[22]

[21] Principles Regarding Cross-Border Supervisory Cooperation, page 14.

[22] Principles Regarding Cross-Border Supervisory Cooperation, page 17.