



June 24, 2016

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Re: Section 871(m) Implementation Date Delay

Dear Ladies and Gentlemen:

The Securities Industry and Financial Markets Association (SIFMA)<sup>1</sup> is submitting this letter with respect to the January 1, 2017 implementation date of the final and temporary regulations (the “Regulations”) under section 871(m) of the Internal Revenue Code (the “Code”). On March 31, 2016 SIFMA submitted a comment letter on the Regulations. We appreciate and acknowledge the significant engagement Treasury and the IRS have afforded to SIFMA and other market participants concerning the implementation of the Regulations, as well as the productive discussions underway concerning open points in the Regulations.

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<sup>1</sup> SIFMA is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets, raising over \$2.4 trillion for businesses and municipalities in the U.S., serving retail clients with over \$16 trillion in assets and managing more than \$62 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit <http://www.sifma.org>.



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SIFMA's members have been working intensively since the Regulations were issued to design systems and processes to implement the required withholding and information reporting. However, it has become clear that SIFMA's membership, which includes all major U.S. and multi-national broker-dealers and banks, will not be in a position to implement the Regulations in their current form on January 1, 2017 due, in part, to the overall complexity of the Regulations, and to the absence of additional or final guidance on several key points. We therefore respectfully request that the implementation date be delayed until at least one year following the date on which guidance resolving the issues outlined below is finalized. SIFMA members have been endeavoring to build systems to implement withholding under Section 871(m) by January 1, 2017 and therefore contemplated requesting a deferral for only certain instruments rather than a full deferral. While certain members believe that they would be able to implement withholding on delta one single name instruments by January 1, 2017, the members agreed that a staggered implementation is not realistic or advisable due to the absence of guidance on qualified derivatives dealer ("QDD") rules (as discussed below) and the complex interplay between different areas of the Regulations.

There are four primary areas awaiting final or additional guidance that are critical to the development of systems and processes for withholding and reporting: (i) QDD rules, (ii) rules for listed options and other instruments held through intermediaries, (iii) rules for combining transactions, and (iv) rules for nonqualified indices.

First, with respect to the QDD rules, our member institutions are multinational organizations with dealer entities located in numerous jurisdictions. In order to design a system to implement the Regulations, our members must understand the responsibilities and treatment of each of their affiliated entities with respect to withholding and information reporting. Any system designed without final guidance would by necessity be incomplete and subject to failure, and could prove to be wholly inadequate when the QDD rules are finalized. Even if guidance were to be received shortly, significant efforts will be required once the rules are finalized in order to register all relevant entities as QDDs and QIs (if required) and for counterparties to properly document the entities prior to trading. Moreover, depending on what the QDD rules ultimately provide, material changes may be required to the way multinational financial institutions hedge equity derivatives to avoid cascading withholding. At the government's request, in anticipation of the release of updated QDD guidance, SIFMA has not provided detailed comments on the QDD rules, but there are a number of fundamental concerns with the basic rules provided by the Temporary regulations.

Second, with respect to listed options, it has become evident that the Regulations have open points that will require a market solution prior to designing an effective system. For instance, a gating item to assessing the applicability of the Regulations to a listed option is what

party is required to calculate and disseminate delta information. At this time, it is not clear how and when delta is to be calculated on listed options, and there is discord in the market on which parties are in a position to calculate and provide the information.<sup>2</sup> Without guidance, it is unlikely that a market consensus will be reached, making it difficult for member institutions to apply the Regulations to listed options, potentially leading to wide-spread market disruption and unintended noncompliance with the Regulations. Even once guidance is issued, members will need time to implement systems to comply. This issue also exists with respect to instruments that trade through intermediaries, such as structured notes. The implementation of the Regulations with respect to these instruments is particularly complex and time-consuming because it requires cooperation between issuers, custodians, paying agents, brokers, clients and vendors. Coordination among the various market participants will require further guidance and adequate lead time to develop systems that can be implemented by the various stakeholders.

Third, with respect to the combination rules, as we have previously noted, our membership cannot implement the combination rule as currently drafted. We continue to devote considerable effort to designing a workable method to apply the concepts of the rules to the realities of the market. So far, we have not been able to develop an approach that is workable. Moreover, any system that applies the combination rules to the enormous volume of transactions that pass through member institutions will be elaborate and complex to administer. Members will need a significant amount of time to build and test such a system to ensure it accurately combines transactions.

Fourth, there are many areas of the Regulations, particularly the rules regarding non-qualified indices, which require clarification. The Regulations require decomposing a non-qualified index and assigning a separate delta to each component. This is inconsistent with how delta is calculated for business purposes for many of these trades (and could be economically distortive), and would be a significant burden to implement. Also, the Regulations do not address what happens if the components of a non-qualified index are modified or the weighting changes, even if such changes occur by operation of the rules of the index, and do not address what happens if an index references an underlying derivative, such as an option. The implementation date should be delayed so that the industry and the government have the necessary time to develop additional workable guidance on these points.

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<sup>2</sup> Letter from Craig S. Donohue, Executive Chairman, The Options Clearing Corporation, to United States Treasury and Internal Revenue Service (Jun. 9, 2016) (on file with SIFMA).



Finally, as a practical matter, SIFMA members expect to rely on multiple third-party vendors for much of the information necessary for compliance with the Regulations.<sup>3</sup> SIFMA and SIFMA members are working closely with vendors to encourage development of reliable products but, to our knowledge, there are currently few, if any, vendors who have data readily available to provide to industry participants. Even once vendors are prepared to provide data, financial institutions will need time to build and test systems to access the data.

Accordingly, in light of the issues discussed above, we strongly urge the government to issue guidance as soon as possible that will defer the implementation date until at least one year following the date on which guidance resolving the issues outlined above is finalized.

Thank you for your consideration of these issues. Please do not hesitate to contact me at (202) 962-7300 or [ppeabody@sifma.org](mailto:ppeabody@sifma.org), or our outside counsel Jeffrey Hochberg at Sullivan & Cromwell LLP. Jeffrey can be reached at 212-558-3266 or [hochbergj@sullcrom.com](mailto:hochbergj@sullcrom.com).

Respectfully submitted,

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<sup>3</sup> For example, SIFMA members are contemplating relying on third-party vendors for information regarding qualified indices, and for delta and dividend equivalents for instruments that are held through intermediaries. We respectfully request that the government provide written guidance that reliance on reputable vendors for relevant information is permitted.



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