

IRS Public Hearing on Proposed Regulations on FATCA Implementation – May 15, 2012

Oral comments presented on behalf of
the Securities Industry and Financial
Markets Association (SIFMA)

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Opening Remarks

- Thank you for the opportunity to speak here today on behalf of SIFMA.
- SIFMA represents securities firms that are
 - regional, national or multinational firms
 - U.S. owned or foreign owned firms, and
 - are fully engaged in projects to become FATCA compliant

Agenda

- Among the most critical issues facing members of SIFMA are
 - I. The proposed timelines for implementing FATCA, and
 - II. Sales of securities settled under a delivery vs. payment (DVP) or cash on delivery (COD) instruction
- Other issues are identified and discussed in SIFMA's written submission

I. Timeline for Implementing FATCA

- First, SIFMA urges that
 - the date for identifying pre-existing accounts be uniform for both USFIs and PFFIs, and
 - The applicable date should be 1/1/2014 instead of
 - 1/1/2013 for USFIs, and
 - 7/1/2013 for PFFIs that enter into a FFI agreement by that date
- Similar adjustments should be made for reporting and withholding
 - The first year of reporting on U.S. accounts by PFFIs should be calendar year 2014
 - FATCA withholding should start on 1/1/2015 for FDAP income and gross proceeds
- Harmonization is needed to ensure a level playing field between USFIs and PFFIs, especially when doing business in same country
- Beginning of the year start better than mid-year start – want to apply rules consistently throughout the tax year

Policy Concerns

- PFFI reporting on US accounts – modest delay of 6 months from 9/30/2014 to 3/30/2015
- Tracking changes in account status for 1st 6 months of 2014 (thru 7/1) to do 2013 reporting overly difficult to achieve
 - because industry practice is to freeze status of accounts at year end to do reporting for prior year so as not to misreport accounts whose Form W-8 expires at the end of the prior year
- Concern with accuracy of information as to account status at if due diligence is not complete
- Need time to perfect working of new procedures

Monumental Tasks

- Both USFIs and PFFIs need sufficient time to
 - design, develop, test and place into production new account data bases to identify the FATCA status of the various new categories of
 - account holders (PFFIs, NPFFIs, deemed-compliant FFIs, exempt beneficial owners, territory financial institutions, QI branches of a USFIs, excepted NFFEs or passive NFFEs)
 - and beneficial owners (specified U.S. persons and substantial U.S. owners of NFFEs)
 - Develop new compliance procedures and establish adequate controls and oversight
 - Educate relationship managers, clients and operations personnel about the new rules and procedures
 - Collect and validate new tax documentation
 - Perform due diligence on pre-existing accounts

Issues Facing Global Financial Institutions

- Large financial institutions that offer a wide range of financial services
 - e.g., consumer banking, private banking, fund services, institutional custody and clearing services, institutional cash management, corporate agency and trust, retail brokerage, prime brokerage, securities lending, foreign currency transactions and derivative transactions
 - and conduct the business globally in many countries,
 - Must design and implement solutions for each type of business activity
 - and perhaps each location if centralized solutions are not feasible
- Must also evaluate and determine the status of thousands of foreign affiliated entities and special purpose vehicles
- Identify countries where conflicts with foreign law exist and determine solutions

Resource Limitations

- Managing a large scale, major systems project that has multiple phases
 - Account due diligence, withholding, reporting
- And affects multiple major payment and transaction systems
- Requires a carefully timed and coordinated effort
 - Typically, major systems can be placed into production only on a few fixed dates each year
 - The impact of new systems on existing processes needs to be evaluated and tested
 - Code contention might prevent work being done simultaneously on different parts of the overall system
 - Schedule to minimize potential for disruption of business as usual
- Requires technology personnel with particular expertise which is in short supply
- Competes with other regulatory or business initiatives

Projecting the Timeline for Implementation

- With its comment letter, SIFMA submitted a project plan and projected time table for the development of documentation and withholding systems by a multinational group of affiliated financial institutions
- This indicative plan was derived from the actual planning efforts of SIFMA members
- It demonstrates that the timetable in the proposed regulations cannot realistically be met

II. Delivery vs. Payment Transactions

- In a sale of securities effected on a delivery vs. payment (DVP) or cash on delivery (COD) basis,
 - A custodian delivers the securities sold against the simultaneous
 - Payment of the cash proceeds by the executing broker
- The sale transaction will not settle unless the cash payment is made for the agreed upon amount at the time the securities are delivered
- Executing brokers buy or sell securities through an exchange (an agency transaction) or from inventory (a principal transaction)
- Executing brokers do not hold securities in custody for its clients and do not maintain cash balances in customer accounts

Treatment of DVP Transactions under Chapter 61

- Since 1984, the responsibility for performing backup withholding and information reporting on gross proceeds from the sale of securities in a DVP transaction has been vested in the custodian that receives the payment of gross proceeds on behalf of the seller (i.e., the seller's agent bank) [Treas. Reg. 1.6045-1(c)(3)(iv)]
- The executing broker has not been required to collect U.S. tax forms or perform withholding on such sale transactions
- This rule has operated to identify the responsible broker when there are at least two brokers involved in a single sale transaction and thus avoid double reporting or withholding

Proposed Changes in FATCA

- In contrast, the FATCA proposed regulations
 - appoint each broker involved in a DVP sale as a withholding agent, and
 - Would require each broker to determine its withholding obligation based on the FATCA status of its payee
 - [Prop. Reg. §1.1472-2(a)(2)(v)]
 - The payee is generally the person to whom a payment is made, regardless of whether such person is the beneficial owner of the payment [Prop. Reg. 1.1471-3(a)(1)]

Market Impact of Proposed Rules

- Primary concern is that trades will fail to settle and that will cause substantial market disruption
- If the executing broker pays only 70 percent of the agreed upon price for the securities, the custodian bank will not deliver the securities on the scheduled settlement date
- Cascading effect on interdependent transactions—
 - If the executing broker does not settle the sale transaction,
 - The purchaser will not be able to
 - settle a short sale or
 - prevent a failure to deliver on another transaction or
 - Return borrowed securities

Implementation Impact

- Given the staggering volume of DVP/COD transactions each day, any change to the current practice would require substantial efforts by executing brokers
- Executing brokers have no systems in place to document receiving brokers or perform information reporting on such transactions
- Since executing brokers
 - maintain a wide variety of trading platforms, and
 - each customer can use different custodians in different markets,
- It is unlikely that executing brokers would be able to develop new systems and procedures to properly document each trade and perform withholding and reporting when required under the current timetable

SIFMA Recommendation

- Modify the proposed regulations, consistent with the Chapter 61 rules, to require that FATCA reporting and withholding be performed only by the USFI or PFFI that receives gross proceeds from an executing broker in a DVP sale
- To prevent abuse, this rule could be limited to transactions executed through a clearing organization that is a USFI (DTCC) or PFFI (e.g., Euroclear or Clearstream), or
- If the trade is not cleared through such a clearing organization, the executing broker would need to document the receiving broker as a PFFI or USFI

Any Questions?

