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Re: Final IRC § 871(m) Regulations Effective Date

Ladies and Gentlemen:

The Futures Industry Association ("FIA") appreciates having had the opportunity to meet with you earlier this year to discuss the application of the final and temporary regulations implementing Internal Revenue Code ("IRC") § 871(m) (the "Regulations") to exchange-traded future and options on futures contracts in securities and security indices listed for trading on US and non-US markets. As we explained then, uncertainty surrounding the interpretation of certain provisions of the Regulations, combined with the difficulty in determining the security-based futures and options on futures contracts that are in scope, have presented significant challenges to our member firms as they work to comply with the Regulations.

We understand that, since our meetings, the Internal Revenue Service (the "Service") has determined to maintain the January 1, 2017 implementation date of the Regulations for "delta one" products and postpone the implementation date by one year for all other in-scope products. We write, therefore, to request the Service to grant the same postponement with

respect to exchange-traded futures and options on futures contracts, many of which may be delta-one products. We also want to take this opportunity to highlight for the Service once again the principal challenges our members face in developing procedures and systems necessary to comply with the Regulations.

Background

FIA is the leading trade organization for the global futures, options and over-the-counter cleared derivatives markets. Its mission is to support open, transparent and competitive markets, protect and enhance the integrity of the financial system and promote high standards of professional conduct. FIA's core constituency consists of futures commission merchants ("FCMs"), and the primary focus of the association is the global use of exchanges, trading systems and clearing organizations for derivatives transactions. FIA's members also include leading derivatives exchanges and clearing organizations from more than 20 countries.

FIA's FCM members serve as the primary clearing members of US futures exchanges. They handle more than 90 percent of the customer funds held for trading on the exchanges and provide the majority of the funds that support the clearing organizations of the exchanges. In providing these clearing services, they commit a substantial amount of their own capital to guarantee customer transactions. With few exceptions, FIA member firms are also registered as broker-dealers with the Securities and Exchange Commission and share the same systems, and thus systems challenges. Fifteen member firms are also direct or indirect subsidiaries of global systemically important banking organizations.

FCMs carry the accounts of US and non-US customers for trading on both US and non-US futures and options on futures markets. In addition to futures on individual securities that are traded on OneChicago Exchange, futures and options on futures contracts in approximately 60 security indices are traded on five US exchanges and more than 275 security indices are traded on 35 non-US exchanges.

Only three non-US exchanges – Eurex, ICE Futures Europe and Singapore Exchange Limited – are qualified under IRC § 1256(g)(7). Eurex lists approximately 125 security indices; ICE Futures Europe lists approximately 50 security indices and Singapore Exchange lists approximately 20 security indices for trading.

Operational Challenges and Need for Postponement and Clarification

The responsibilities of non-US clearing organizations must be clarified. Since our meetings earlier this year, we have become aware of a new issue that affects both non-US clearing organizations and FCMs that carry the accounts of non-US customers that enter into transactions on futures and options on futures contracts cleared by such non-US clearing organizations. Specifically, questions have been raised as to whether such non-US clearing organizations should be deemed to be withholding agents or should qualify for an exemption. As explained below, if non-US clearing organizations are deemed to have withholding

obligations, the impact on pricing of relevant futures and options on futures contracts, and on liquidity in the markets for such contracts, could be significant.

As the Service may be aware, US FCMs generally are not clearing members of non-US clearing organizations. Rather, the US FCM maintains a customer omnibus account with a non-US clearing member of such clearing organization, and the identity of the FCM's underlying customers is not known to the non-US clearing member or to the clearing organization.

All derivatives transactions that are accepted for clearing through a clearing organization are novated, with the clearing organization becoming the buyer to every seller and the seller to every buyer. In these circumstances, the clearing organization may be viewed as a principal to every transaction and required to act as another withholding agent. Such a result could expose a US FCM's non-US customers to cascading withholding of up to 60 percent, depending on the treaty and FACTA status of the clearing organization and long party. Such a result would impose a significant financial burden on non-US customers.[1]

Although the Regulations provide relief from cascading withholding in circumstances involving qualified derivatives dealers ("QDDs"), non-US clearing organizations do not appear to be "eligible entities" as defined under the Regulations and, therefore, they would not be able to take advantage of the QDD exemption.

The risks of cascading withholding are not ameliorated if, in the alternative, a non-US clearing organization were deemed to be acting solely as an intermediary. In this case the non-US clearing organization would need to pass information to short FCMs regarding the long principals to the relevant transactions or agree to withhold and report on long FCMs to obtain withholding Qualified Intermediary status in order to get an exemption on trades where the clearing house is short.

In light of the above, we ask the Service to clarify the obligations of non-US clearing organizations and, if necessary, take appropriate action to relieve such clearing organizations of any withholding obligations.

FCMs lack essential information and systems to meet the January 1, 2017 implementation date. FIA member firms have been working diligently since the final rules were promulgated to determine the futures and options on futures products that are within the scope of the Regulations and to design systems and processes to implement the required withholding and information reporting. To this end, however, FCMs must rely on the exchanges that list these products and third-party vendors. In particular, FCMs must rely on

[1] It is also uncertain how, as a technical matter, a non-US clearing organization would be able to pass through a long FCM's tax form and its own Form W-81MY to a short FCM.

such exchanges to determine the products that are in scope, provide the necessary delta calculations[2] and provide information regarding the payment of underlying dividends.

In this regard, we reached out to global exchanges earlier this year to familiarize them with requirements of IRC § 871(m) and to request necessary information from those exchanges to identify the security indices that are in scope. However, we have been unable to obtain the requested information from a number of exchanges. In addition, we understand that not all are prepared to provide necessary information to withholding agents and the vendors that will assist such agents.

We have also sent questionnaires to vendors offering assistance as they develop systems to meet the withholding requirements of IRC § 871(m) and have made responses available on FIA's website (https://mt.fia.org/irs-871m-regulations) for member use. Based on responses to date, it is clear that these vendors will not be in a position to provide the necessary systems to FCMs by the January 1, 2017 implementation date.

The party responsible for withholding must be clarified. All transactions executed on or subject to the rules of a futures exchange for or on behalf of a customer are executed through an FCM acting as agent for its customer. A customer that trades futures or options on futures contracts on a US or non-US exchange may, and indeed regularly do, use the services of more than one FCM to effect the trade. For example, a customer may maintain, or carry, an account with an FCM – the clearing FCM – that is a clearing member of the exchange on which the customer wishes to execute a trade but elect to use the services of another FCM – the executing FCM – to execute the trade on the exchange. In such circumstances, the customer will instruct the executing FCM to "give-up" the trade to the customer's clearing FCM to clear the transaction through the related clearing organization. Crucially, the FCM that executes the transaction may not know the identity of the customer or, if it does, it likely will not have all of the information necessary to determine whether withholding is necessary.

A customer may also wish to execute a trade on an exchange where the FCM carrying the customer's account is not an exchange or related clearing organization member. In this event, the FCM carrying the customer's account will execute the trade through a customer omnibus account that the carrying FCM maintains with an FCM that is a member of the exchange clearing organization. (The carrying FCM could also use a separate executing FCM that will give up the trade to a clearing FCM in the same manner as described above.) Similarly, when a transaction is executed on a non-US exchange, the FCM carrying the customer's account will cause the trade to be executed and cleared through a member (or members) of that exchange.

In each of these circumstances, only the FCM that is carrying the customer's account, *i.e.*, the FCM with which the customer has entered into a customer agreement and which carries both the customer's trades and related customer funds on a fully-disclosed basis, has the information necessary to determine whether withholding is necessary. Further, because the identity of a

[2] We understand that not all futures and options on futures contracts on security indices will have a delta of 1.0.

customer is not disclosed to its counterparty when a transaction is executed on an exchange, only the FCM carrying an account for the customer that has purchased – or is "long" – the contract has such information.

In light of the above, we request the Service to confirm that, under the Regulations, only an FCM that carries an account for a customer that is "long" a particular transaction has an obligation to withhold, if appropriate. This would address the issue that we addressed earlier in this letter with respect to the non-US clearing organizations as well.

An end-of-day delta calculation should be adopted. As we discussed in our meetings, we request the Service to confirm that FCMs may calculate delta based on the prior day's closing price. Using an end-of-day calculation method, rather than real-time or intraday calculations, to assess whether a particular contract is subject to withholding is more efficient and would significantly reduce the burden that would otherwise be placed on FCMs.

Any required withholding should take place when delta information and dividend information is provided to the carrying FCM. A customer may request that one or more open futures and options on futures contracts be transferred from one carrying FCM to another carrying FCM where the customer has an account. If a customer requests the transfer of open positions subject to withholding, the carrying FCM receiving the transferred positions must have confidence that any required withholding has been made. This is particularly true in the case of combination trades, because the FCM receiving the transferred positions may not be aware of all transactions that make up a combination trade.

We request that the Service confirm that, in these circumstances, any required withholding occur promptly when delta information and information with regard to dividend payments with respect to the underlying securities are provided to the FCM then carrying the customer's account.

Conclusion

For all of the reasons set forth above and to ensure that FIA member firms are ready to comply with the Regulations, we ask that the effective date of the Regulations implementing IRC §871(m) be deferred until January 1, 2018 or until one year following the date on which the Service replies to the requests for confirmation set out above. We would be happy to share with you the information we have gathered from our member firms and third parties concerning the state of readiness for these important regulatory changes.

Sincerely,

Allison Lurton
Senior Vice President and General Counsel