COMMITTEE ON SECURITIES LENDING

September 20, 2010

Mr. Stephen Schaeffer
Office of Associate Chief Counsel (Procedure & Administration)
CC:PA:LPD:PR (REG-101896-09)
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, D.C. 20024

RE: Comments on Proposed Regulations on Cost Basis Reporting (IRS REG-101896-09)

Dear Mr. Schaeffer:

The Risk Management Association's Committee on Securities Lending ("RMA")[1] submits this letter in response to certain requirements contained within the proposed cost basis reporting regulations, REG-101896-09, published on December 16, 2009, ("CBR"). These regulations were issued as a result of new statutory requirements enacted by Section 403 of Public Law 110-343, *The Energy Improvement and Extension Act of 2008*, 122 Stat. 3854.

The RMA appreciates the efforts of the Internal Revenue Service ("IRS") and the Department of Treasury ("Treasury") in drafting regulations to ensure accurate and complete reporting of gross proceeds derived from sales. However, we are concerned that application of certain CBR requirements in the securities lending context will result in enormous expense and burden to taxpayers without furthering the goals of the new rules. Specifically, we believe there is no purpose advanced by requiring transfer statement reporting in the securities lending context, as, in general, there is no gain or loss recognized with respect to a typical transfer of securities pursuant to a securities lending agreement[2] and, more importantly, a transfer statement would provide no useful cost basis information to the receiving broker or its customers. As a result, for the reasons set forth below, we join several other industry organizations including the Securities Industry and Financial Markets Association ("SIFMA"), in urging the IRS and Treasury to exclude transfers with respect to securities lending transactions from the transfer statement reporting requirements in the final regulations.[3]

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[1] Founded in 1914, the RMA is a not-for-profit, member-driven professional organization whose sole purpose is to advance the use of sound risk principles in the financial services industry. RMA has over 2,700 institutional members that include banks of all sizes as well as nonbank financial institutions throughout North America, Europe, and Asia/Pacific. RMA's Committee on Securities Lending was formed in 1983. The objective of the Committee is to promote sound securities lending practices within its members and the industry. In the securities lending context, the members of RMA primarily act as "agent lenders" loaning securities on behalf of principal lenders.

[2] See Section 1058 of the Internal Revenue Code of 1986 and discussion below.

[3] On February 8, 2010 and June 11, 2010, SIFMA submitted correspondence to the IRS advocating that securities lending transfers be exempted from the transfer statement requirement under the final regulations.

New § 6045A of the Internal Revenue Code ("IRC") requires every applicable person effecting a transfer of *covered securities*[4] to a "broker" to provide a written statement to the receiving broker in such manner and setting forth such information as the Secretary may by regulations prescribe for purposes of enabling such broker to meet the requirements of section 6045(g), which sets forth the requirement to report adjusted basis information on Form 1099-B when the broker's customer disposes of the transferred securities.[5] Section 6045(g) provides that every broker that is required to file a return with the IRS under section 6045(a) showing the gross proceeds from the sale of a covered security must include in the return the customer's adjusted basis in the security and whether any gain or loss with respect to the security is long-term or short-term. At the time of drafting the transfer statement reporting rule of IRC § 6045A, Congress' primary stated intent was to enable the receiving broker "to satisfy the basis and holding period reporting requirements" of IRC § 6045(g).[6] This intent reflected the legislation's overall goal of improving Form 1099-B compliance and assisting taxpayers in accurately calculating their respective capital gains and losses. Pursuant to the authority conferred under the relevant statute, the IRS and Treasury later expanded the scope of transfer statement reporting to include transfers of all *specified securities*, including *noncovered securities*, and with respect to all transferees, including exempt recipients.[7] This appears to include transfers resulting from securities lending transactions.[8] For the following reasons, we urge the IRS and Treasury to exclude securities lending transfers from the scope of the final regulations:

1. **Lender's Cost Basis Information Is Irrelevant to Receiving Broker And Its Customers.** Under IRC § 1058, a transfer of securities pursuant to a securities lending agreement is not a taxable disposition of property so long as the conditions under IRC § 1058 are satisfied. Furthermore, the lender's basis at the time of the transfer and holding period associated with the loaned securities are preserved throughout the term of the loan and are not transferred to the borrower.[9] Thus, there is no requirement for Form 1099-B for the loan transfer as there is no taxable event. More importantly, providing the receiving broker with the lender's cost basis information is of no use to the receiving broker or its customer (the borrower of loaned securities) and will not assist the broker in meeting its Form 1099-B obligations, the stated purpose of the transfer statement requirements of section 6045A. Thus, requiring transfer statement reporting for securities lending transfers that comply with § 1058, which represents the vast majority of securities lending transfers, will not contribute to the purpose of the legislation or advance the goals of the IRS or Congress.

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[4] IRC § 6045(g)(3) defines a *covered security* as any "specified security" purchased on or after January 1, 2011 in the case of equities (other than stock of a regulated investment company ("RIC") or stock that is part of a dividend reinvestment plan ("DRIP"); January 1, 2012 in the case of RIC or DRP stock; and, January 1, 2013 in the case of any other security unless exempted by the IRS. A *specified security* is any share of stock in a corporation; any note, bond, debenture, or other evidence or indebtedness; any commodity or contract on such commodity; and, any other financial instrument determined by the IRS to be appropriate for cost basis reporting.

[5] The provision is effective for U.S. and non-U.S. equity transfers occurring on or after January 1, 2011.

[6] Joint Committee on Taxation, *Technical Explanation of H.R. 7060, the "Renewable Energy and Job Creation Tax Act of 2008," as Scheduled for Consideration by the House of Representatives on September 25, 2008* (JCX-75-08), p. 136, September 25, 2008.

[7] See Prop. Treas. Reg. § 1.6045A-1(a)(1) and (b)(2)(i).

[8] The expanded scope also appears to include transfers with respect to standard repurchase agreements.

[9] The lender's basis and acquisition date of "identical securities" returned by the borrower is the same as the lender's basis and acquisition date at the time of the loan transfer.

2. **Majority of Participants are Exempt Recipients**. The CBR requirements, inclusive of the transfer statement reporting requirement, are intended to enhance existing Form 1099-B reporting. Regulations promulgated under IRC § 6045 exempt certain entities from Form 1099-B reporting. For example, entities registered under the Investment Company Act of 1940 and tax-exempt retirement funds are generally not subject to Form 1099-B reporting.[10] Mutual funds and exempt retirement funds comprise the largest pool of beneficial owners that participate in the U.S. securities lending industry. The above exemption notwithstanding, the proposed regulations appear to prescribe transfer statement reporting for *all* securities lending transfers, even those undertaken by non-U.S. entities and U.S. entities that are exempt from Form 1099-B reporting. Thus, a significant portion of the proposed transfer statements will be issued to brokers on behalf of entities that are not subject to Form 1099-B reporting.

3. **Additional Information Provided by the Transfer Statement is Already Available.** The Preamble to the proposed regulations suggests that the sole premise underlying the policy of transfer statements in securities lending transactions is to enable the receiving broker to satisfy the basis reporting requirements of section 6045(g) with respect to its Form 1099-B reporting obligations. In describing the reason for requiring these statements, the Preamble highlights the need to alert the receiving broker effecting a short sale for its customers that shares transferred to cover the short sale are in fact borrowed, to ensure the receiving broker does not report the sale on Form 1099-B (since the sale remains open under IRC § 1233). In practice, however, the majority of the securities loans originate with custodians acting as agents for large institutional investors, and these custodians act without knowledge of whether or not the transferred securities will be used to facilitate a short sale or for some other purpose. For example, a U.S. custodial bank may participate in lending the portfolio assets of their clients (*e.g.*, a RIC) to other financial institutions, typically broker-dealers, which may be acting on either a proprietary or intermediary basis. The U.S. custodian will generally enter into an industry-standard Securities Lending Agreement with the broker-dealer without any knowledge of how the broker-dealer intends to use the securities borrowed. Under the proposed regulations, the U.S. custodian will be required to issue a transfer statement to the broker-dealer which indicates that the securities are borrowed and that the basis in the securities equal zero. This transfer statement will not provide incremental information by alerting the broker that the shares are borrowed, since the broker-dealer initiated the borrow from the custodial agent.

4. **Returns of Borrowed Securities and Collateral Transfers.** The proposed regulations provide specific guidance regarding the need for transfer statements when a transferred security is borrowed from an applicable person or when an applicable person facilitates the transferred security. The language of the proposed regulations, however, fails to address the transfer that occurs when the borrower returns identical securities to the lender at the completion of the term of the loan ("loan return transfer"). This oversight has caused significant confusion in the industry as to whether transfer statements are

[10] See Treas. Reg. § 1.6045-1(c)(3)(i)(B).

indeed required on loan return transfers and what information should be included on the transfer statements. As detailed above, any information conveyed in a transfer statement associated with a loan return transfer will not be pertinent to either Form 1099-B reporting by the receiving broker or subsequent transfers of the same securities. Therefore for the reasons set forth above, we urge the Treasury and IRS to clarify that transfers of securities effected as part of a loan return transfer are outside the scope of transfer statement reporting.

As currently written, the proposed regulations also appear to require transfer statements when collateral securities are transferred (including on collateral return transfers) as security for a securities loan. The reporting of collateral transfers, if required, would create another level of unnecessary administrative burden and confusion to the affected persons given that the actual transfer and return of collateral securities are not taxable dispositions, and the furnishing of a transfer statement to a receiving broker (on behalf of a collateral recipient or provider) will not assist the broker in meeting its Form 1099-B obligations. A transfer statement in these circumstances provides no relevant information for purposes of Form 1099-B reporting, and therefore the RMA respectfully urges the IRS and Treasury to clarify that transfers of collateral securities are also outside the scope of transfer statement reporting under the final regulations.

For the reasons detailed above, in finalizing the cost basis reporting regulations, the RMA urges the IRS and the Treasury to exempt securities lending transfers and related collateral securities transfers from the transfer statement reporting requirements.

If you have any questions regarding the comments provided, please feel free to contact xxx

Sincerely,

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RMA Executive Committee Chairman

Christopher R. Kunkle
RMA Director of Securities Lending

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