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Jeffrey Van Hove
Office of Tax Legislative Counsel
U.S. Treasury Department
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

Re: Final Regulations on Cost Basis Reporting -- Securities Lending Issues

Dear Mr. Van Hove:

In December of 2010, Jeanne Ross, who at the time was an Attorney-Advisor in your office, arranged a conference with representatives from the Internal Revenue Service Office of Associate Chief Counsel (Procedure & Administration), and representatives of the Risk Management Association's Committee on Securities Lending ("RMA")¹. The purpose of the discussion was to review the scope of the transfer statement requirements under new § 6045A of the Internal Revenue Code ("IRC") in the context of "agent lenders" and custodians that transfer securities on behalf of principal lenders pursuant to securities lending transactions described in IRC § 1058.

RMA submitted comments² on these issues in response to the proposed regulations³ issued under IRC § 6045A. In those comments, RMA urged the IRS and Treasury to exclude transfers with respect to securities lending transactions from the transfer statement reporting requirements in the final regulations. RMA was pleased that this general principle was followed in the final regulations

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 Letter from RMA to Mr. Stephen Schaeffer, Office of Associate Chief Counsel (Procedure & Administration), September 3, 2010 (Tax Analysts, Document 2010-20101).

³ REG 1018960-09 (December 16 2009).

issued last year under IRC § 6045A.⁴ In particular, those regulations state that, “A transferor that lends or borrows securities *as a principal* is not required to furnish a transfer statement for a security that is transferred pursuant to such lending or borrowing arrangement (for example, when a customer opens or closes a short sale).” Reg. § 1.6045A-1(a)(1)(iv) (emphasis added).

RMA understands that this general exception for securities loans was intended to apply in the case of “normal” securities lending transactions where an “agent lender” loans securities on behalf of principal lenders. Since the beneficial owner of the securities (and the person described as the “transferor” under IRC § 1058) is the “principal” in the transaction with the securities borrower, then the fact that such loans are arranged and implemented by an “agent lender” should not limit the scope of the exception described above. In addition, the agent lender’s role in the transaction should not trigger a separate reporting requirement imposed on the agent as a “transferor”, regardless of the fact that the agent lender negotiates and implements the transaction on behalf of the principal lender. Similarly, the lender’s custodian bank should not be treated as a separate “transferor” in this transaction.

Moreover, we note that the borrower in the normal agency securities lending transaction will be a financial institution that, in virtually all cases, will satisfy one or more tests as an “exempt recipient” under § 1.6045-1(c)(3)(i) or an “exempt foreign person” under § 1.6045-1(g)(1)(i). In that case, RMA also understands that the “transfers” to such borrowers pursuant to a securities lending transaction should qualify as exempt from transfer statement reporting under § 1.6045A-1(a)(1)(iii), since in each case, the securities will be held “after the transfer” by an exempt recipient.

Nevertheless, the regulatory exception provided in § 1.6045A-1(a)(1)(iv) is qualified by additional rules that have raised questions among industry participants with respect to the intended scope of the securities lending exemption. Specifically, the regulation states, “This exception does not apply when a transferor transfers a security under a lending or borrowing arrangement of the customer. This exception also does not apply when a transferor transfers a previously borrowed security to another account of the same customer (for example, to satisfy an existing short sale obligation).”

RMA understands that these two “carve-outs” were not intended to apply to the normal securities lending transactions effected through lending agents and custodian banks; but rather to ensure that proper reporting occurs for short sale participants under § 1.6045A-1(b)(4) and other situations where brokers dealing with borrowed securities require additional information from the transferor to clarify the applicable relationships. For example, where a borrower of securities transfers the securities to open or close its customer’s short sales, then a broker receiving the securities in those transactions needs to know that the securities are borrowed in order to comply with the rules in § 1.6045-1(c)(3)(xi). Similarly, if an open short sale position is “moved” to a different broker, the original broker will need to make a transfer statement described in § 1.6045-1(c)(3)(xi)(C) so that

⁴ T.D. 9504 (October 12, 2010).

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information regarding the original short sale (including the amount of the original short sale proceeds) is passed to the new broker. Finally, in unusual cases where a loan of covered securities is “moved” mid-stream to a different broker, the preamble to the regulations explains that “transfer statements will ensure that securities returned to the lender or collateral provider remain covered securities even if the securities are returned to a different account.”⁵ There is no similar need for transfer statements, however, in normal section 1058 transactions where a lender’s agent simply transfers securities on behalf of the securities lender (acting as principal in the loan) directly to a securities borrower.

As we discussed, it would be helpful to both the government and the financial services industry to follow a uniform and consistent interpretation of these rules. Accordingly, RMA requests that the IRS publish a statement (or an example) on its website or in other appropriate guidance implementing the new IRC § 6045A requirements that confirms the above conclusions. In particular, RMA suggests that such implementing guidance clearly state the following: (i) the fact that a “lending agent” (or custodian bank) is involved in negotiating or implementing a securities lending transaction does not trigger a transfer statement requirement, provided that the party represented by the lending agent acts as a “principal” in the transaction; and (ii) if the borrower of the securities is an “exempt recipient” under § 1.6045-1(c)(3)(i) or an “exempt foreign person” under § 1.6045-1(g)(1)(i), then any transfers of securities to such a borrower pursuant to a securities loan will not trigger any transfer statement requirement.

We attach as an appendix a proposed set of Q&A’s that could be used to provide confirmation of these conclusions.

Again, we appreciate your time and consideration of these issues with RMA. Please do not hesitate to contact us if we can provide further assistance on these matters.

Best regards,



Rom P. Watson

CC: Mr. Stephen Schaeffer, Office of Associate Chief Counsel (Procedure & Administration)

Bruce McDougal, Chair of the Legal, Tax Regulatory Subcommittee of the Securities Lending Committee of RMA

⁵ See Reg. § 1.6045A Preamble, T.D. 9504, (October 12, 2010).

APPENDIX

Q-1. Where a custodian bank or other financial institution acts as a securities lending agent on behalf of a securities lender or is otherwise involved in negotiating or implementing a securities lending arrangement described in Code section 1058, would the lender of securities (or the securities lending agent or other custodian) under such an arrangement be required to provide a transfer statement under section 6045A?

A-1. No. Pursuant to Regulation § 1.6045A-1(a)(1)(iv), neither a securities lender (acting as the principal in a section 1058 transaction), nor a lending agent (or other custodian) that is involved in negotiating or implementing the transaction on behalf of the lender, is required to furnish a transfer statement to the securities borrower. Moreover, if the borrower of the securities is an “exempt recipient” or an “exempt foreign person,” then a transfer statement is also exempted pursuant to Regulation § 1.6045A-1(a)(1)(iii).

Q-2. Would the borrower of securities be required to provide a transfer statement upon the return of securities to the lender at the close of a transaction described in Code section 1058?

A-2. No. The borrower is also not required to provide a transfer statement to the securities lender (or to the lender’s agent or custodian) when securities are returned to close a Code section 1058 transaction. Regulation §§ 1.6045A-1(a)(1)(iii) and (iv). However, if the borrower of the securities makes a further transfer of the borrowed securities to effect a short sale, then the borrower may be required to furnish a transfer statement to a receiving broker when the short sale transaction is closed or transferred to another account pursuant to the rules in Regulation §§ 1.6045A-1(b)(4) and 1.6045-1(c)(3)(xi). See also, Regulation § 1.6045-1(c)(4), Examples 8 and 9.