FINANCIAL INFORMATION FORUM

5 Hanover Square
New York, New York 10004
_____
212-422-8568

January 27, 2012

Electronic Delivery and FedEx

Pamela Lew
CC:PA:LPD:PR (REG–102988–11)
Room 5203
Internal Revenue Service
P.O. Box 7604, Ben Franklin Station,
Washington, DC 20044

Re: Basis Reporting by Securities Brokers and Basis Determination for Debt Instruments and Options
      [REG-102988-11]

Dear Ms. Lew,

The Financial Information Forum (FIF) [1] would like to take this opportunity to provide our initial response to the notice of proposed rulemaking published by the Internal Revenue Service, U.S. Department of the Treasury (IRS) on November 22, 2011 regarding basis reporting by securities brokers and basis determination for debt instruments and options.

As discussed in our November 18, 2011 letter [2], FIF urges the IRS to delay the effective date for fixed income reporting until a minimum of 18 months after issuance of final regulations due to the complexities of calculating and tracking basis for this very diverse group of financial instruments. The draft table in Appendix 1, which is still a work in progress, lists the various data elements available from different systems within a broker-dealer, which are needed in a timely manner for accurate Fixed Income basis calculation including adjustments for original issue discount and amortization/accretion of market premiums/discounts

Cost basis reporting is no longer offered as a value-added service but rather as an obligation under 1099 reporting rules and, as this multi-year initiative enters into its second stage, the industry is only now reporting, for the first time, adjusted basis on covered equity securities. As such, considerable resources are being devoted to developing effective communications strategies designed to minimize client confusion with the changes that went into effect in January 2012. As part of efforts to ensure on-going compliance with the 2011/2012 requirements, the industry is refining processes for securities already considered covered and also preparing for 2013, which in many cases will require a substantial rewrite

---

[1] FIF (www.fif.com) was formed in 1996 to provide a centralized source of information on the implementation issues that impact the financial technology industry across the order lifecycle. Our participants include trading and back office service bureaus, broker-dealers, market data vendors and exchanges. Through topic-oriented working groups, FIF participants focus on critical issues and productive solutions to technology developments, regulatory initiatives, and other industry changes.

of existing fixed income and options processing systems. As we move further into 2012, we will be in a better position to assess the extent of the issues that have been uncovered incidental to year end 1099 reporting, and those related to tracking basis on mutual funds. We have already become aware that the handling of manual mutual fund transfers is problematic and will vie for resources this year along with 2013 basis tracking requirements.

The FIF Cost Basis Working Group has concerns that focus on specific portions of the basis reporting requirements as drafted. FIF plans on providing detailed commentary under separate cover; however, at this time we would like to relay the most critical issues and proposed recommendations that require the IRS's immediate consideration:

a) The effective date for fixed income reporting should be delayed for a minimum of 18 months after issuance of final regulations[2]. Firm assessments of the magnitude of work associated with building out and testing systems to process amortization, accretion and other fixed income products calculations support this needed timeframe. Additionally, some member firms that have implemented systems that calculate bond amortization and accretion, have been quick to warn that their implementations were multi-year projects that required a minimum of 6 months of detailed testing after deployment because of all of the different bond types and complexities. These firms also note that even their systems, as built, will require substantial work to comply with the proposed regulations.

b) Include safe harbor language in the final regulations for brokers who rely in good faith on data or systems thought to be correct when calculating, transferring or reporting basis on fixed income or options

c) The very broad definition of fixed income securities subject to basis reporting should be reconsidered and more narrowly defined. While the section 1272(a)(6) exclusion is helpful, a universe of specifically defined securities subject to basis reporting (especially during a multi-year transition period) would facilitate a smoother implementation by limiting the software development challenges currently known and the unanticipated demands that may be placed upon the industry as new financial instruments are developed and new issues are uncovered related to currently available debt instruments.

d) Fixed Income transfer requirements should be changed to mandate the transfer of original basis/acquisition cost and the data necessary to calculate adjusted basis from the date of original issuance or acquisition by the account holder

e) All options subject to Section 1256 should be excluded from 1099 basis reporting[3].

f) An ongoing dialogue should be opened as soon as possible between the IRS and representatives of the securities industry to bring clarification to where confusion exists in the understanding or application of the proposed regulations and Industry practices.

---

[2] See FIF Letter to the Treasury on Fixed Income Cost Basis Reporting Concerns for a detailed discussion of this issue.

[3] Requiring mark to market securities tracked with basis adjustments will prove confusing for the taxpayer. If the IRS does require reporting on a segment of 1256 options, FIF believes specific guidance on which options are and are not subject to that reporting is needed and that their treatment for wash sale purposes should be clarified. Additional details to follow in detailed FIF letter on REG-102988-11

A preliminary survey of our membership indicates that a majority of FIF member firms are experiencing a surge in customer apprehension and confusion over the changes in 1099B reporting, the ongoing need for basis related calculation adjustments in accounts, and the complexities associated with transfers. The industry continues to address outstanding issues with the Phase 1 implementation such as inaccurate data resulting from transfers, manual correction of transfers, missing corporate action data, adapting to the use of new forms (8949, 8937, revised 1099B), and an increase in data volumes due to the need to track sub-lots. This coupled with the need to comprehensively analyze, develop, test, deploy and communicate the changes required to accurately provide basis information for fixed income securities and options beginning in 2013 increases the probability of industry-wide inconsistency and inaccurate compliance. There is also a finite amount of tax reporting resources available within firms. Any spare capacity this group might have had is already being expended on the finalizing of section 871(m) compliance for March 2012, and the early stages of requirements gathering and systems design to implement the multi-year phase in of FATCA. Additional hired staff cannot add much value when their learning curve will be longer than the lead time remaining to implementation in 2013. It should also be noted that the resource contention issues created by these multiple demands go beyond staffing resources (i.e., the subject matter experts, software developers and system testers), extending to hardware and software resource utilization. Most systems that are processing financial transactions were not designed to facilitate simultaneous development on the same strands of code.

With deadlines and requirements remaining as they are, FIF expects difficulties in processing basis for fixed income products across the industry and even greater challenges with some of the more exotic transactions affecting options processing. The short timeframe available for implementing this new basis tracking and reporting is just not sufficient to ensure that a pool of 'covered' bonds and options is reported with accurate and reliable basis data. With this outcome, the objective of enhanced taxpayer compliance through broker basis reporting on Form 1099 will not be achieved to its fullest extent. It is for all of the reasons and concerns expressed within this letter that the FIF, most importantly, reiterates its recommendation that the fixed income implementation date be delayed. Additionally, FIF believes the final regulations should contain a safe harbor for brokers who rely in good faith on data or systems thought to be correct when calculating, transferring or reporting basis on fixed income or options for a reasonable time.

FIF appreciates having had this opportunity to convey its critical concerns and looks forward to furnishing a more detailed comment letter addressing how the issues and challenges of complying with the proposed regulations may be minimized.

Regards,

Arsalan Shahid
Program Director, Financial Information Forum
On behalf of FIF Cost Basis Working Group

Appendix 1: Fixed Income Cost Basis Components (Work In Progress as of Jan 27, 2012)

Asset Type	Covered Under Proposed Regulations	Data required report on 1099 OID	Data required to amortize/accrete bond discount and Premium	Data Source
Corporate Bond	Y	• Issue Date • Issue Price • Adjusted Issue Price • Redemption Price • Any Qualified Stated Interest payment amounts (available in broker trading system) • Any Non Qualified Stated Interest amounts (need to report as OID and is included in redemption price of bond)	• Interest Rate • Coupon Periods • Maturity Date (to calculate YTM) • Call Dates	• Security Master • Trading System • External Data Vendor(s)*
Municipal Bond	Y	• Issue Date • Issue Price • Adjusted Issue Price • Redemption Price • Any Qualified Stated Interest payment amounts	• Interest Rate • Coupon Periods • Maturity Date (to calculate YTM) • Call Dates	• Security Master • Trading System • External Data Vendor(s)*
Government Agency Bonds (foreign)	Y	• Issue Date • Issue Price • Adjusted Issue Price • Redemption Price • Any Qualified Stated Interest payment amounts	• Interest Rate • Coupon Periods • Maturity Date (to calculate YTM) • Call Dates	• Security Master • Trading System • External Data Vendor(s)*
US Agency	Y	• Issue Date	• Interest Rate	• Security Master

* There is no one vendor that provides reliable information for all required data sources. It requires compiling information from multiple vendors for rates, coupon periods, maturity dates, call dates and OID information.

Asset Type	Covered Under Proposed Regulations	Data required report on 1099 OID	Data required to amortize/accrete bond discount and Premium	Data Source
Bonds		• Issue Price • Adjusted Issue Price • Redemption Price • Any Qualified Stated Interest payment amounts	• Coupon Periods • Maturity Date (to calculate YTM)	• Trading System • External Data Vendor(s)[*]
Private Debt	Y	• Issue Date • Issue Price • Adjusted Issue Price • Redemption Price • Any Qualified Stated Interest payment amounts	• Interest Rate • Coupon Periods • Maturity Date (to calculate YTM)	• Security Master • Trading System • External Data Vendor(s)[*]
Treasury Note	Y	• Issue Date • Issue Price • Adjusted Issue Price • Redemption Price • Any Qualified Stated Interest payment amounts	• Interest Rate • Coupon Periods • Maturity Date (to calculate YTM)	• Security Master • Trading System • Vendor External Data Vendor(s)[*]
Treasury Bond	Y	• Issue Date • Issue Price • Adjusted Issue Price • Redemption Price • Any Qualified Stated Interest payment amounts	• Interest Rate • Coupon Periods • Maturity Date (to calculate YTM)	• Security Master • Trading System External Data Vendor(s)[*]
Treasury Strip	Y	• Issue Date • Issue Price	• Interest Rate • Coupon Periods	• Security Master • Trading System

[*] There is no one vendor that provides reliable information for all required data sources. It requires compiling information from multiple vendors for rates, coupon periods, maturity dates, call dates and OID information.

Asset Type	Covered Under Proposed Regulations	Data required report on 1099 OID	Data required to amortize/accrete bond discount and Premium	Data Source
		• Adjusted Issue Price • Redemption Price • Any Qualified Stated Interest payment amounts	• Maturity Date (to calculate YTM)	• Vendor • External Data Vendor(s)*
Treasury Inflation Protection Security/ Inflation Indexed Securities	Y	• CPI period-end • CPI period-begin • CPI Issue Date • PAR	• CPI period-end • CPI period-begin • CPI Issue Date • PAR • Amount Issued • Amount Outstanding	• Security Master • Trading System • External Data Vendor(s)*
Variable Rate Bonds	Y	• Issue Date • Issue Price • Adjusted Issue Price • Redemption Price • Any Qualified Stated Interest payment amounts	• Interest Rate • Coupon Periods • Maturity Date (to calculate YTM) • Call Dates • Rate Schedules	• Security Master • Trading System • External Data Vendor(s)*
Interest Paying Debt Issued as at a discount	Y	• Issue Price • Adjusted Issue Price • Redemption Price • Any Qualified Stated Interest payment amounts (available in broker trading system) • Any Non Qualified Stated Interest amounts (need to report as OID and is included in redemption price of bond)	• Interest Rate • Coupon Periods • Maturity Date (to calculate YTM) • Call Dates	• Security Master • Trading System • External Data Vendor(s)*

---

* There is no one vendor that provides reliable information for all required data sources. It requires compiling information from multiple vendors for rates, coupon periods, maturity dates, call dates and OID information.

Asset Type	Covered Under Proposed Regulations	Data required report on 1099 OID	Data required to amortize/accrete bond discount and Premium	Data Source
Fixed Rate Capital Trust Securities (Hybrid Preferreds)	Y	• Issue Price • Adjusted Issue Price • Redemption Price • Any Qualified Stated Interest payment amounts (available in BP&T) • Any Non Qualified Stated Interest amounts (need to report as OID and is included in redemption price of bond) • Bond Unit Factor	• Unknown what data elements would be required to calculate or if is required.	• Security Master • Trading System • Vendor • External Data Vendor(s)*
Equity Unit Trusts	Y	• Issue Price • Adjusted Issue Price • Redemption Price • Any Qualified Stated Interest payment amounts (available in BP&T) • Any Non Qualified Stated Interest amounts (need to report as OID and is included in redemption price of bond) • Bond Unit Factor	• Unknown what data elements would be required to calculate or if is required.	• Security Master • Trading System • External Data Vendor(s)*
Payment in Kind Bonds	Y	• Issue Date • Issue Price • Maturity Date • Coupon – Initial and Step • Redemption value • PIK Accrual Schedule	• Interest Rate • Coupon Periods • Maturity Date (to calculate YTM) • Call Dates	• Security Master • Trading System • External Data Vendor(s)*
Contingent	Y	• Issue Price	• Unknown what data elements	• Security Master

---

* There is no one vendor that provides reliable information for all required data sources. It requires compiling information from multiple vendors for rates, coupon periods, maturity dates, call dates and OID information.

Asset Type	Covered Under Proposed Regulations	Data required report on 1099 OID	Data required to amortize/accrete bond discount and Premium	Data Source
Payment Securities		• Adjusted Issue Price • Redemption Price • Any Qualified Stated Interest payment amounts (available in BP&T) • Any Non Qualified Stated Interest amounts (need to report as OID and is included in redemption price of bond) • Expected Return provided by Issuer • Projected Payment Schedule to match	would be required to calculate or if is it required.	• Trading System • External Data Vendor(s)[*]
Certificates of Deposits – Market Place	Y	• Issue Price • Adjusted Issue Price • Redemption Price	• Interest Rate • Coupon Periods • Maturity Date (to calculate YTM) • Call Dates	• Security Master • Trading System External Data Vendor(s)[*]
Certificates of Deposit – non market place	Y	• Issue Price • Adjusted Issue Price • Redemption Price	• Interest Rate • Coupon Periods • Maturity Date (to calculate YTM) • Call Dates	• Security Master • Trading System • External Data Vendor(s)[*]

----

[*] There is no one vendor that provides reliable information for all required data sources. It requires compiling information from multiple vendors for rates, coupon periods, maturity dates, call dates and OID information.