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April 30, 2012



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Re: Regulations Relating to Information Reporting by Foreign Financial Institutions and Withholding on Certain Payments to Foreign Financial Institutions and Other Foreign Entities – Comments on Notice of proposed rulemaking REG-121647-10

Dear Sirs and Mesdames:

The Institute of International Finance (IIF) appreciates the opportunity to comment on the proposed regulations amending chapter 4 of Subtitle A of the Internal Revenue Code of 1986 regarding information reporting by foreign financial institutions (FFIs) with respect to US accounts and withholding on certain payments to FFIs and other foreign entities released by the Internal Revenue Service (IRS) on February 8, 2012 (the "Proposed Regulations"). This letter also comments on the bilateral agreements (the "Bilateral

Agreements”) proposed between the US and five other countries in the joint statement of February 8, 2012 (the “Joint Statement”).

Although the Institute does not normally comment on national tax proposals, the Foreign Account Tax Compliance Act (FATCA) is of such international significance that an exception seemed in order. This letter will also be sent to the Financial Stability Board (FSB), Organization for Economic Cooperation and Development (OECD) and Committee on Payment and Settlement Systems (CPSS), reflecting the IIF’s conviction that the issues raised by FATCA need to be tackled on a truly international basis.

The IIF shares the goal of FATCA to prevent tax evasion, and welcomes the IRS’s acknowledgement that it presents a significant undertaking for financial institutions, as well as the efforts made in the Proposed Regulations to address industry concerns. The Institute also welcomes the Joint Statement announcing an Intergovernmental Approach to Improving International Tax Compliance and Implementing FATCA issued by the US, France, Germany, Italy, Spain, and the UK. The Joint Statement is a good first step toward dealing with the data privacy issues arising out of FATCA.

While recognizing the important steps that have been taken in order to address several of the industry concerns, there are a number of issues that still should be considered before finalizing any implementing regulations. Below we elaborate on the industry’s most salient remaining concerns:

Executive Summary

In its letter dated January 25, 2012, to the G20 Ministers of Finance and central bank Governors with copies to the FSB, the IIF called for a *coordinated global approach* to the problem of tax evasion. The Institute requested that the FSB mandate the development of a global framework for addressing the reporting and tax-compliance issues raised by FATCA. The IIF asked that the extraterritorial and global payment systems aspects of FATCA be put on hold, until such a framework is developed,

The proposal of *Bilateral Agreements* such as those in the Joint Statement with the five European countries and others to be negotiated, is constructive and a welcome step forward. Nevertheless, considerable time will be required to implement them and consistency is essential to avoid creating further complexities in the global system.

Bilateral Agreements are at *best a partial solution* and can only resolve data-privacy and related issues in the specific partner countries. Hence, a more global solution that can be made workable for the broad international community is needed, as the extraterritorial measures that will continue to apply outside the scope of the Bilateral Agreements are unlikely to generate solutions that will work in an integrated global financial system.

Additionally, there are various aspects of FATCA that would require substantial changes, in order to foster a more globally coordinated system that will prevent tax evasion challenges. These include, *inter alia*, due diligence challenges, concerns regarding payments systems issues arising from ‘passthru’ withholding, FFI Agreements, as well as challenges to

insurance companies, trade finance, and capital market transactions that are further outlined below.

The requirement that *all* members of an expanded affiliate group as defined by the Proposed Regulations be either a participating FFI, or deemed-compliant, is of concern to firms active in many jurisdictions. Despite the limited transitional relief until 2015, this requirement does not reflect the complexities of the global markets.

Progress had been made in providing relief on the *due diligence* aspects of FATCA, however, there is a need for simplicity and clarity. Timing is still a problem as FFIs cannot begin implementation of FATCA with any certainty as to its requirements until the final regulations have been published, the final text of FFI agreements is released and Bilateral Agreements are ratified, although some firms have nonetheless already started major implementation programs in order to meet FATCA deadlines. There is need for further consultation on operational issues. For example, due diligence for foreign entities still poses problems. There are serious legal issues remaining. Furthermore, there are potential conflicts with counterparties' contractual rights that appear unlikely to be covered in partner country agreements, and of course will continue to arise with customers and counterparties in other countries. One partial solution would be to more closely align FATCA requirements to existing KYC and AML rules.

The Institute is especially concerned about the *payment systems issues arising from the withholding and "passthru" requirements* of FATCA. The Joint Statement recognizes the importance and complexity of developing an effective approach to "passthru" payments that minimizes the burden on FFIs. However, the IIF is concerned that addressing "passthru" withholding under an ad-hoc process of the partner countries is not the optimal approach. Establishing an international standard, mediated by the FSB and with G20 political impetus would be much more likely to result in a coherent system. There is also a danger that the bilateral approach taken in the Bilateral Agreements will result in the fragmentation of global markets, creating a division between FATCA partner countries and non-FATCA partner countries, in addition to the division between participating and non-participating Foreign Financial Institutions (FFIs).

The industry awaits publication of *template FFI Agreements*, allowing firms to become "participating" FFIs. Time will be required to work them out on – as is essential – a globally consistent basis. Firms are concerned that they may be required to sign such agreements before having full knowledge of important aspects of FATCA, such as "passthru" withholding obligations. Firms should not be obliged to sign such agreements until all requirements can be fully understood, especially as serious questions of compliance with applicable non-US law and potential private liability remain unresolved. At the least, the unclarified aspects of FATCA should not be included in the initial agreements that firms would be expected to sign.

Insurance companies have a number of acute concerns arising from the fact that FATCA requirements do not seem to take into account the specificities of insurers' business model and practices, and could create a host of irresolvable issues.

A special issue arises for *capital markets transactions*. Although the extension of the grandfather date in the Proposed Regulation is welcome, the problem still remains that transactions must be negotiated without a full understanding of what the ultimate requirements will be. Given the need for consistent market interpretations, it would be better to align the grandfathering date to the clarification of requirements.

Further special issues arise in areas such as *Delivery versus Payment ("DVP") transactions, Trade Finance* and other finance transactions. In these areas especially, further work is required to avoid disruption of international markets and international commerce.

Market education: In addition to working through the very complex and as yet incomplete corpus of FATCA regulations and, as yet undrafted, domestic rules for those in partner countries firms are already encountering widespread misunderstanding and misapprehension when FATCA issues are raised with counterparties and clients. Educating market participants on the implications of FATCA and ensuring that they understand their obligations is essential. Clear and broadly understood guidance would be helpful in minimizing disruptions to global payments systems.

General Discussion

The following discussion develops more fully the points raised in the Executive Summary and raises a number of specific points that are of concern to international firms. This discussion does not purport to be comprehensive, and many other associations will be submitting detailed comments on specific issues. However, the Institute hopes that these observations will be useful to the US Treasury and the IRS as they review the current status of the FATCA proposals, and will serve as a useful guide to the overall issues for the other addressees of this letter.

Bilateral Agreements

Welcome step forward. In the context of the Proposed Regulations, the proposed Bilateral Agreements are important and constructive. Recognition of the importance of the data-privacy issue is a clear step forward. When completed, such agreements will be helpful in dealing with data privacy and reporting issues for the large amounts of domestic business banks conduct in partner countries. However, the international agreements would, even if fully carried out as envisioned, represent a solution to only a portion of the problems posed by FATCA.

Nonetheless, considerable time will be required. Although several countries are in the process of negotiating agreements with the IRS, such agreements and the necessary enabling legislation will take time to complete and there are many jurisdictions that will not be able to enter into agreements with the IRS by the time FATCA due diligence and reporting requirements come into effect, in some cases because they do not have existing tax treaties with the US. Therefore, the current implementation timetable is unlikely to be met and will need modification.

Consistency is essential. Moreover, it will be important to assure that such Bilateral Agreements are fully consistent, to avoid creating further complexities in the global system.

Without a harmonized approach the result could be multiple and inconsistent compliance regimes, which could be counterproductive in combating tax evasion and create unnecessary burdens on international transactions because of the challenges of sorting through different requirements for different clients and counterparties, and create compliance risk for firms.

Only a partial solution. Welcome though the proposed agreements will be to financial institutions in the partner countries when ratified and implemented, even an expanded network of such agreements is not likely to resolve all the issues for many years if ever. Such Bilateral Agreements can only resolve data-privacy and related issues in the specific partner countries and, of course, leave open such issues in non-partner countries; furthermore, it seems unlikely they would resolve such issues for transactions between partner countries (at least outside the EU) unless very great care is taken, or a multilateral approach is adopted.

As discussed further below, it is not clear that even the proposed agreements would resolve issues of contractual liability or problems of withholding on payments, which remain of acute concern in many countries.

Need for a global solution. It is important to reiterate the fundamental point that uncoordinated, extraterritorial measures by one or a few countries are unlikely to generate broadly accepted solutions that will work in an integrated global financial system.

The complexity of FATCA requirements as currently proposed is such that it could be counterproductive to developing a broadly accepted multi-lateral approach. The comprehensive and US-specific nature of FATCA reporting requirements, make it less likely that many jurisdictions, especially those with less mature taxation regimes and simpler economies, will be able to enter into Bilateral Agreements. However, a truly global solution could and should be simpler, less prone to compliance error, and more comprehensive.

Withholding and Payments Systems Issues

Danger of fragmentation of global markets. Because it is likely that the bilateral approach will leave many cross-border issues unresolved, IIF must caution that the Bilateral Agreements as currently planned would create a division in international markets between FATCA partner countries and non-FATCA partner countries. This creates an unlevel playing field and could materially affect global trade. That would compound the further division that would arise between “participating” FFIs, which, outside the partner countries, will have to sign agreements with the IRS, and “non-participating” FFIs. Moreover, within the partner countries, there may be non-participating FFIs. This will create a highly complex system, given that “non-participating” FFIs will be subject to 30% withholding on payments to or through them of US funds by US financial institutions and by “participating” FFIs. This raises payments and other issues discussed further below.

Timing is very tight. The Institute is concerned that the withholding and “passthru” payments sections of FATCA will largely be addressed only at a later date and that the withholding requirements are deferred for only two years. The dauntingly complex issues relating to the determination of “passthru” payments have been left vague and subject to future developments, but remain a pressing concern, and the timeline does not look

generous for resolution of the many legal and technical problems, given the complexity and scope of the issues.

This serious timing concern raises formidable questions for planning, developing, and implementing systems changes within firms and possibly within market infrastructure.

Need to seek the simplest solutions. The legality of withholding for FATCA purposes remains problematic in many countries, and, even if the strictly legal issues were resolved, the problems of operationalizing the information requirements could be formidable, depending on how the ultimate requirements are defined. Resolving this issue will require common knowledge and a definition at a global level of the different types of transactions to enable their automatic identification in the payment chain.

It is critical to resolve these issues in a manner that does not burden the international payments systems, and international commerce more generally, with complex information requirements derived from complicated regulations and definitions that do not correspond to other operational definitions in the system, yet there is substantial fear that such could be the result if care is not taken.

Withholding should be required only at the level of the entity that actually has access to the relevant information. Any solutions should avoid putting complex information burdens on the system and rather focus on reporting, and, once legal problems are resolved, withholding.

DVP Transactions. Proposed Regulations should be revised to limit withholding and reporting responsibilities under FATCA for DVP/Cash on Delivery (“COD”) transactions to the US financial institution or “participating” FFI receiving gross payment from a counterparty or an executing broker. Under the proposed regulations all brokers, including executing brokers involved in these transaction have reporting and withholding responsibilities. This is not consistent with existing backup withholding rules for such transactions, which require reporting and backup withholding by the broker receiving gross proceeds of securities sold, rather than the executing broker. As many US executing brokers have such accounts they would have to set up procedures to apply FATCA withholding and reporting. A more practical solution would be for the broker holding securities for the client to be responsible for FATCA withholding and reporting; this would be consistent with the important general proposition, that withholding obligations should fall on intermediaries with knowledge of relevant issues and not create information requirements that flow through the system.

Trade Finance. The impact of FATCA on trade finance is of concern. Trade finance transactions including; import/export letters of credit, documentary bankers’ acceptances, trade acceptances and open-account payments resulting in payments to a party other than an FFI, either directly, or through an FFI, may be subject to FATCA requirements. These transactions are of particular concern when payment is made through a “non-participating” FFI, which may often be the case with emerging-markets transactions. This is also of particular concern for groups with affiliates in many countries. The industry believes that the unintentional, but potentially disruptive impact on global trade should be considered and that trade-finance transactions should be exempted from FATCA reporting and

withholding as they are, on the one hand, not very likely to raise the underlying concerns of FATCA, and, on the other, imposing complex FATCA compliance requirements is likely to make it less likely that major-market banks will be willing to continue such low-margin business, especially given the other new burdens on such transactions arising in other regulatory regimes, notably Basel III.

Considering the goals of FATCA, financing activities generally should be explicitly excluded from the definition of financial accounts under FATCA. The same should apply for any collateral provided.

Complexity and Compliance. The highly complex FATCA rules would, if imposed in their present form, require compliance review of many payments in addition to existing KYC and other compliance issues. At least until FATCA is widely understood, this is likely to cause many payments and transactions to be held up for review, as firms will wish to avoid compliance failures, on the one hand, and liability to clients and counterparties for incorrect withholding or reporting on the other. While such burdens are perhaps inevitable at some level, there is a serious argument here for simplification to the greatest extent possible of FATCA requirements and, once again, for uniform, global, and well-understood requirements that all can implement – and understand – on an even basis.

Need for an international solution. The Joint Statement contains a paragraph indicating that the signatory countries “commit to develop a practical and effective alternative approach to achieve the policy objectives of ‘passthru’ payment withholding that minimizes burden.” This recognition of the importance and complexity of the problem is important; however, it is not clear that this would be conducted as an internationally coordinated effort through the OECD; rather it appears to contemplate an ad-hoc process of the partner countries. Moreover, it will be important to include full consideration of the issues of efficiency and integrity of the international payments system in this process, as well as tax and reporting issues.

The IIF is of the view that it will be essential to have G20-level political impetus behind such an effort, mediated through the FSB, even if the detailed development tasks are left to the OECD in consultation with the Committee on Payment and Settlement Systems (the “CPSS”) as well as the industry and essential infrastructure institutions such as SWIFT, to make sure that payments issues are carefully taken into account in working through to solutions. From this perspective, it would not be appropriate to leave this process to ad-hoc efforts among the partner countries.

Capital Markets Transactions

The market still has concerns regarding payments on capital-markets transactions. Although the clarification on the definition of “financial account” and on extension of the grandfathering date to January 1, 2013 are certainly helpful, the lack of clarity on what the eventual “passthru”, withholding and reporting rules, and the need for guidance on a number of technical details, will be at best complicate negotiation of transactions and contribute to the overall uncertainty on this and many other issues now burdening the capital markets, especially for obligations of financial institutions. This uncertainty, especially where the interaction of FATCA and other bodies of prudential regulation and contract law is

uncertain, creates concerns about potential gross-up liabilities that will affect capital market pricing.

Align grandfathering with clarification of requirements. Thus, the effects of these rules would be much easier to manage for all concerned, and create much less uncertainty in the markets, if grandfathering could be linked to the finalization of the relevant requirements including FFI agreements, rather than being issued on a stand-alone basis that may not work with the overall finalization of the FATCA regime.

FFI Agreements

An essential element of FATCA implementation will be the signature of FFI Agreements for firms to become “participating” FFIs. While it is understood that template agreements will be available presently, firms will need time to consider the proposals and their adaptation to local law, although such agreements should be uniform insofar as possible across firms, it seems likely that comments on form and substance to the IRS will be necessary before a fully workable international form of agreement can be established.

The IIF understands that the objective is to encourage wide participation in FATCA, however, if FFI agreements are expected to be signed early in 2013 there must be certainty as to the scope of the agreement. For this reason, any provisions for “passthru” payments or other aspects of FATCA compliance that are not finalized and well understood should be removed from the scope of the FFI agreement. It is difficult to see how any firm’s Board of Directors or senior management could authorize signature of such an agreement under conditions where serious questions of compliance with applicable law and private liability remain open.

Affiliates “All or nothing” Rule

The “all or nothing” rule for participating FFIs, which generally requires *all* members of the expanded affiliate group to be participating FFIs or deemed-compliant (with certain limited exceptions) is of concern to firms active in many jurisdictions. Although there is limited transitional relief until the end of 2015 for FFIs that are unable to comply with FATCA under local law, if some of a FFI’s affiliates are subject to restrictions that prevent full FATCA compliance under applicable law, the whole group (even if headquartered in a FATCA partner country) could be considered non-participating after 2015. The Proposed Regulations allow for non-reporting group members, and this goes some way to alleviating the problem for expanded affiliate groups, but hardly solves the problem.

Complex issues of application. FFIs that operate in jurisdictions with legal prohibitions preventing them from achieving full FATCA compliance will require changes in local law to maintain FFI status or to achieve non-reporting status. It is anticipated that this will also be the case where a jurisdiction wishes to enter into a Bilateral Agreement.

Therefore, given the time necessary to amend domestic laws and negotiate Bilateral Agreements, the deadline for compliance with the “all or nothing” rule should be extended.

In addition, assurance that compliant FFIs in expanded affiliated groups will not lose their preferred FATCA status if they can demonstrate they have made good faith attempts to obtain the requisite legal changes would be welcome.

The “registered deemed-compliant FFI category” also poses problems in certain instances. In the case of members of expanded affiliated groups, each member of the expanded affiliated group must be in the same country. If a FFI is doing business in a number of jurisdictions, but deals almost entirely with domestic customers in each of these jurisdictions it would seem that this should satisfy the intention of the deemed-compliant category. This is particularly relevant for life insurance companies, that are generally restricted to dealing with domestic clients in the different jurisdictions in which they operate.

Broader implications. The “all or nothing” rule remains an intrusive requirement that does not reflect the complexities of the global marketplace. Firms should be able to establish their businesses where it makes sense to do so. This proposed rule, in addition to putting global groups in a very difficult position, would contribute to fragmenting the global market at the very time when the G20 and FSB have recognized the global nature of the market and are working toward global standards. Aside from its unfair effect on certain groups, it will tend to undermine rather than enhance the kind of global solutions that are needed to make FATCA-type tax rules truly effective.

The “all or nothing” rule is sure to compound the complexities and potential for confusion and error in payments. Would a firm headquartered in a partner country be “tainted” by an affiliate that cannot comply and cease to come under the partner country exemption? The tracking problems would thereby be compounded.

The unwieldy expanded affiliate group concept will continue to create complexity in the international markets even if the problems with application to expanded affiliate groups on an “all or nothing” basis are resolved. This can only contribute to the fragmentation of markets and general inefficiency that the G20 has set out to prevent. Therefore, once again, the most satisfactory solution would be simple, generally applicable standards that can be applied on a global basis.

Data Collection and Data Privacy Issues

Under the proposed Bilateral Agreements with the US, partner countries will have to enact enabling legislation and this will take some time. This legislation will need to include dealing with protection of the data transferred by FATCA partner countries to the IRS. The details and timelines for the proposed agreements’ becoming effective are very unclear, which compounds the problems of developing systems and compliance programs. As noted above, the fact that FATCA information requirements do not align with most domestic reporting requirements should not be underestimated. For example, in the EU many accounts are opened using an electronic credit reference check and looking for US indicia in data obtained by an automatic ID check will be difficult. Aligning the requirements under the Proposed Regulations with existing practice would assist in meeting FATCA implementation deadlines.

For FFIs operating in multiple jurisdictions, with headquarters or other offices in a FATCA partner country and affiliates in others, the Bilateral Agreements, even if enacted as announced, will not solve the problem of FATCA compliance, and may actually compound it. The Bilateral Agreements will apparently only address data privacy issues for domestic business in single countries; it does not appear that they will address data privacy issues affecting either cross-border business into other countries (even, possibly, other partner countries, nor certainly with non-partner countries).

It is not clear whether firms in partner countries would have to sign FFI agreements with the IRS to be “participating” FFIs, or on what terms, for their business outside of each specific partner country.

Due Diligence and Reporting: Partial Relief, not a Complete Solution

There has been progress in providing relief on the due diligence aspects of FATCA, but a number of issues remain. Timing is still problematic, as most FFIs will need at least several months after the *final* regulations have been published, the final text of FFI agreements released and binding joint international agreements ratified to complete implementation of the due diligence process. The burdens and complexities of these developments without clear indication of final requirements should not be underestimated, especially at a time when the FSB and national regulators are pressing the industry for a host of other risk-management and stability related systems developments that will consume scarce resources as well as requiring substantial investments.

Need for simplicity and clarity. The reporting requirements remain onerous in the sense that they do not mesh well with reporting requirements financial institutions are already complying with in many countries, and by 2015 will include the name, address, TIN, account balance, aggregate gross interest, dividends and other income paid to the account, as well as gross proceeds. Participating FFIs will also be required to report the year-end aggregate number and value of recalcitrant accounts. For substantial US owners of a US owned foreign entity, reporting requirements include information on gross receipts, withdrawals and payments from the account. Limiting reporting requirements to identification and account balances would significantly reduce the cost and complexity to FFIs of developing reporting systems, and would allow the IRS to check discrepancies with the client’s own reporting on a case by case basis through ordinary exchange of information channels.

Aligning the FATCA substantial-ownership standard with the KYC standard of 25% would be helpful in alleviating the problem at least partially. Although the Proposed Regulations recognize the desirability of alignment with KYC and AML requirements, it does not appear that full alignment has as yet been worked into the regulations. The complexity of this issue is compounded by an expansive definition of foreign entities, as discussed further below.

An international solution, based on a single, simplified, consistent template that could be used for multiple purposes, would be in line with efforts the OECD has pursued for some time and would make much more sense. Again, this is why an international mandate for a consistent approach is needed.

Need for further consultation on operational issues. Although raising the electronic search threshold is welcome, its value is undercut in many contexts by the special aggregation rule, which creates a need for manual intervention and involvement of relationship managers. Further consultation with those actually involved in carrying out these duties is needed on this and many other details of the due diligence requirements to make them fully operational.

Although due diligence burdens have been somewhat alleviated for individual accounts, due diligence for foreign entities still poses problems. The conditions imposed to determine substantial US owners are unlikely to be met using existing account information for pre-existing entities and, while extension of the deadline is welcome, the problem will remain formidable for many firms. For new-entity accounts, extensive and detailed requirements are likely to be difficult to satisfy, in part because they conflict with foreign privacy laws and market custom: further work to develop procedures that would both avoid conflicts with local laws and would be proportionate to the risks posed are required.

A more general compliance issue is that, under FATCA, as a general rule, documentary evidence of US indicia is valid for three years and must be renewed thereafter. This requirement is not consistent with existing KYC and AML rules and creates ongoing and burdensome complexity. Renewing documentary evidence would require significant effort and lead to the identification of very few, if any, additional US persons. The requirement to renew documentary evidence with an expiry date should be deleted, or at a minimum the account should not be treated as recalcitrant and subject to withholding.

Remaining serious legal issues. There would be additional legal issues were the IRS to seek *additional information*: in most countries, even assuming Bilateral Agreements as projected, additional information would be available only through normal international legal process.

Furthermore, there are potential *conflicts with contract law* that are not likely to be covered in the partner country agreements. Potential conflicts with contract law go beyond data privacy and reporting issues, and adhering to FATCA requirements may make FFIs and other financial market participants liable to civil suit in some jurisdictions. That an FFI is required to report certain information or to withhold payments for reasons of FATCA compliance is very likely not to be a defense to clients and counterparties asserting their rights under existing agreements, standard deposit or insurance contracts, or under local consumer- or investor-protection statutes. One example discussed below is the inability of insurance companies to unilaterally terminate policies of recalcitrant account holders, but there are many others, which may arise for all types of financial institutions.

Treatment of Non-operating Entities. The Proposed Regulations are unclear about whether non-operating entities, domiciliary companies or passive investment companies are to be treated as non-financial foreign entities (NFFE) or as FFIs. Privately held passive investment entities should be treated as NFFEs not FFIs. The documentation requirements to identify substantial US owners are sufficient to prevent abuse. If required, the definition of an entity considered a FFI because it is engaged primarily in the business of investing, reinvesting or trading in securities should be changed. One possibility would be to limit the inclusion of this type of FFI in the definition to entities regulated as investment funds.

Special Issues for Insurance Companies

FATCA presents many specific problems for insurance companies. While the issues bear some similarity to those facing banks and other financial institutions, the nature of insurance relationships with clients is quite different, with the result that the issues present themselves in different, and sometimes more difficult ways.

FATCA was not designed for the insurance industry and careful tailoring of the rules is necessary. As detailed in many insurance industry letters, many insurance-related definitions, especially regarding “cash value insurance and annuities” and retirement plans must be modified to limit the scope of FATCA to those products that FATCA was intended to cover. Reinsurance and non-life products should not be subject to FATCA. These products relate to transactions between insurance companies or to commercial risks.

The Proposed Regulations do not provide any categories of deemed compliance for insurers. But as suggested in the preamble, one or more types of deemed-compliant FFIs must be created for the insurance industry to have any reasonable likelihood of being able to enter FFI agreements by July 1, 2013. One recommendation is that a life insurer would be deemed compliant if it meets the following two key requirements:

- Almost all of the life insurer’s business is with local residents and it does not market, sell or conduct business in another country. (There could be special rules for EU life insurers and their customers who are residents in any EU state to be treated as residents within one country.)
- On or before the date the life insurer registers as a deemed-compliant FFI, the life insurer must implement policies and procedures to ensure that it does not issue or otherwise sell insurance products to any specified US person who is not a resident of the country in which the life insurer is organized, a nonparticipating FFI, or to any entity controlled or beneficially owned (as determined under the life insurer’s AML due diligence) by a specified US person that is not a resident of the country in which the life insurer is organized.

Because independent brokers and banks distribute a significant portion of life insurance products and control the current AML customer identification processes for such sales, it is vital that the final regulations permit insurers to rely on such third party distributors for customer identification. It also will be very difficult for insurers to update customer identification documentation every three years. Insurers have limited customer contact after sale of their products and may not receive any customer communications until maturity of the particular products many years after their sale. Thus, it is highly unlikely that customers will respond to requests for information to meet FATCA requirements.

As insurance policies are legal contracts, they cannot be unilaterally modified or cancelled. Under the terms of policies, insurance companies are not able legally to terminate policies of recalcitrant policyholders or withhold payments. For this reason, there may be a risk that withholding on “passthru” payments would have to be grossed up and thus paid by the insurance company itself. This in turn will create additional costs not planned for in premium calculations or investment planning.

Need for Market Education

The obligations arising for financial institutions under FATCA are not well understood by many counterparties to transactions affected by FATCA. The full implications of the technical and legal problems cannot be fully appreciated or explained to clients and counterparties at the present time based on the Proposed Regulations, either by FFIs who may be signing agreements with the IRS, or by non-FFI recipients of transactions subject to withholding. There is a great deal of confusion in the market as to what transactions are affected by the Proposed Regulations.

Educating market participants on the implications of FATCA and ensuring that they understand their obligations is essential to firms, which must, beginning now, negotiate terms of transactions and relationships with clients and counterparties, and this need will only become more acute as full implementation comes closer. Moreover, clear and broadly understood guidance would be helpful in minimizing disruptions to global payments systems. The Proposed Regulations are not complete but they are voluminous and difficult to parse without the advice of expert US tax counsel. Making them work globally without confusion, delays, and compliance problems will be very difficult unless the US authorities make very clear what the expectations are. Again, an international solution, established on as straightforward a basis as possible seems the only plausible solution to a massive education and compliance problem.

Deferring the withholding and “passthru” payments aspects of FATCA, as mentioned above, until the market is fully educated on its obligations would make for a more efficient and effective implementation.

Conclusion

The revised approach will still subject FFIs conducting business outside the US to burdensome, extraterritorial US requirements; still create operational and legal risks; still contravene local laws in many places; and still create inefficiencies for the payments system and global finance.

The Institute reiterates its call for an integrated and coordinated process to address FATCA and related issues. The IIF would like to restate its request for the US Treasury and IRS to take up the broad international issues raised by FATCA, including the payment-system and other systemic issues under a global framework. The attempt to deal with the multiple and complex issues raised by FATCA via Bilateral Agreements, although helpful within specific countries, is not helpful toward a workable, truly international solution, and in some ways compounds the problem.

The IIF and its members would welcome the opportunity to work with the US Treasury and IRS to address the multiple and complex issues raised by FATCA through a process of collective consultation. The Institute would welcome the inclusion of international bodies such as the FSB, OECD, and CPSS in the discussion of issues and solutions.

Very truly yours,

A handwritten signature in black ink, appearing to read "David Schuss", followed by a horizontal line extending to the right.