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INVESTMENT COMPANY INSTITUTE

By Electronic Delivery

May 30, 2019

Peter M. Phelan
Deputy Assistant Secretary
Office of Capital Markets
US Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Krishna Vallabhaneni
Tax Legislative Counsel
US Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Michael Desmond
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

RE: UMBS TBA Contracts and Diversification under Section 817(h)

Dear Mr. Phelan, Mr. Vallabhaneni, and Mr. Desmond:

The Investment Company Institute (ICI) and the Securities Industry and Financial Markets Association (SIFMA)[1] appreciate the time that you and your staff spent meeting with us on April 9 to discuss our concerns regarding diversification testing of To-Be-Announced (TBA) contracts for Uniform Mortgage Backed Securities (UMBS) for purposes of section 817(h). To address our members' concerns, we support additional guidance with respect to UMBS TBAs that would permit taxpayers to choose either to (1) apply the deemed issuance ratio or (2) treat the counterparty as the issuer, solely for purposes of section 817(h).

As we discussed, and as outlined in our prior letter,[2] the guidance in Rev. Proc. 2018-54 does not address the critical question of how to test TBA contracts for UMBS. We thus have asked the Treasury Department and the Internal Revenue Service (IRS) to provide that: (1) taxpayers may apply the deemed issuance ratio election described in Rev. Proc. 2018-54 to UMBS TBA contracts; and (2) the deemed issuance ratio election applies separately to a TBA contract and the UMBS that are delivered pursuant to that contract. We also have asked the government to clarify that the "taxpayer" that makes the deemed issuance ratio election with respect to any UMBS or TBA contracts is the entity that acquires those securities (either the

[1] Descriptions of ICI and SIFMA and their respective memberships are attached.

[2] *See* ICI-SIFMA Letter to Krishna Vallabhaneni and William Paul, dated February 11, 2019.

insurance company segregated asset account or the insurance-dedicated fund underlying the segregated asset accounts). If the taxpayer is the insurance company, the election should be made separately for each segregated asset account.

Upon further discussion with our members, we believe that an appropriate solution would permit taxpayers to choose whether to apply the deemed issuance ratio to UMBS TBA contracts or to treat the counterparty of the TBA contract as the issuer, solely for purposes of diversification testing under section 817(h).[3] This option would be in addition to and separate from the application of the deemed issuance ratio to UMBS delivered under a TBA contract. Such guidance would provide taxpayers with certainty regarding the treatment of the UMBS TBA contracts without implicating the treatment of other contracts for this and other purposes. The current lack of certainty will affect negatively our members' ability to successfully manage and advise investment funds and managed accounts. Indeed, because UMBS have begun trading in the TBA market, we understand that the lack of guidance already is having an impact.

We also recommend that the guidance be issued as a safe harbor, rather than as an affirmative election. Further, we recommend that the Treasury Department and IRS similarly amend the guidance in Rev. Proc. 2018-54 to provide for a safe harbor. As we discussed, the entity sub-advising the investment fund or managed account and performing the section 817(h) diversification testing may not be the same entity responsible for filing the tax returns. Thus, a disconnect could exist between the two parties. Also, because an election, such as the deemed issuance ratio election in Rev. Proc. 2018-54, typically is filed with the taxpayer's tax return, the decision to make the election may be made by one party well after the section 817(h) testing must be performed by another. Requiring an election would create unnecessary confusion for all the parties involved, as well as for the IRS. We do not see any reason for requiring an election rather than providing a safe harbor. The Treasury Department and IRS have provided a safe harbor on a similar issue involving government money market funds and section 817(h).[4]

Finally, we reiterate our request above for clarification as to the identity of the "taxpayer" for purposes of this guidance.

ICI, SIFMA, and our respective members appreciate your attention to these issues. Please do not hesitate to contact us if you have any questions or would like to discuss further our requests.

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[3] We note the uncertainties regarding the treatment of derivatives for diversification testing more generally. Our proposal is not meant to address those uncertainties and should be limited solely to the acquisition of UMBS TBA contracts.

[4] Notice 2016-32 provided relief for variable insurance-dedicated government money market funds. If such funds meet certain criteria, they are deemed to satisfy the diversification requirements under section 817(h). We note that the notice indicates the Treasury Department and IRS's intent to issue regulations addressing this issue; such regulations have not yet been proposed.

Sincerely,

Karen Lau Gibian
Associate General Counsel, Tax Law
Investment Company Institute

Chris Killian
Managing Director
Securitization and Credit Markets
SIFMA

Attachment

cc: Craig Phillips
US Department of the Treasury

Alexander Jackson
US Department of the Treasury

Michael Novey
US Department of the Treasury

Alexis MacIvor
Internal Revenue Service

Jeffrey Rodrick
Internal Revenue Service

Katherine A. Hossofsky
Internal Revenue Service

Bob Ryan
Federal Housing Finance Agency

Attachment

The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of US$20.7 trillion in the United States, serving more than 100 million US shareholders, and US$7.0 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in London, Hong Kong, and Washington, DC.

SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate on legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.