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Fatca

Special Report

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Editor's Letter

Future Tense

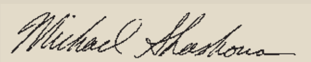
Six months ago, when we published our last special report on the US Foreign Account Tax Compliance Act (Fatca), the industry and regulators appeared to be in the middle of receiving and figuring out what all of Fatca's provisions would be and how to comply with these.

While the details are more certain now, the first major deadline of July 1 for compliance has the industry scrambling to implement plans and be prepared. As our Virtual Roundtable (page 8) panelists say, processes are incomplete or not ready. Some firms are still integrating processes into their systems, and preparedness can depend on how complex a firm and its IT infrastructure are. Overall, many firms are still looking for tools, and their preparedness can vary depending on the model they use, as Thomson Reuters' Tim Lind notes.

While firms may know what needs to be done, they also know that differences between data sources also present a problem for Fatca compliance. Ravi Vasantraj of consultancy Tech Mahindra says the necessary data often "resides in multiple systems, in multiple formats and are sometimes contradictory." A central storehouse is needed, he says, but conflicts between data sources makes creation of one a challenging goal.

Failing that, there's always metadata or cross-referencing of data. SIX Financial Information's Jacob Gertel says counterparty identification is key to such efforts. Edward Sander of Nice Actimize notes that a lot of the necessary information for compliance is already there, it's just a matter of leveraging technology and re-purposing data. July 1 may be the first deadline, but it isn't the last for Fatca compliance, and this report includes views on Fatca's future impact.

Yours sincerely,



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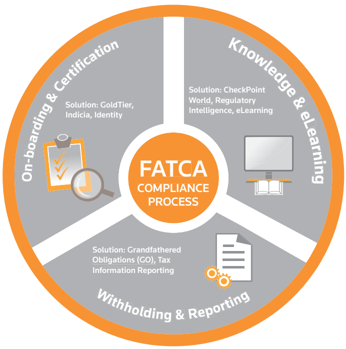

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News Review

Fatca May Nullify 'Grandfathered' Statuses

The newest wrinkle to emerge in preparation for compliance with the US Foreign Account Tax Compliance Act (Fatca) is the possibility certain securities that had been exempt under "grandfather" clauses in the Act could suddenly be subject to the rules if any change deemed a "material modification" is made.

The US Internal Revenue Service (IRS), which administers Fatca, hasn't offered much "prescriptive" guidance yet for Fatca compliance, which leaves uncertainty about the issue of modifications to grandfathered securities, says Dominique Tanner, head of business development at SIX Financial Information, the data services provider.

Securities can be exempt if their maturity date precedes the July 1 date when Fatca onboarding and withholding is expected to begin, or if they are short-term obligations for 180 days or less, as well as certain other "out-of-scope" securities.

Several factors could change a previously "grandfathered" security to one subject to Fatca, including changes in interest rate, mergers, takeovers, any change in control at the firm or entity that is the ultimate borrower, and extensions or reductions of maturities, explains Tanner.

Michael Shashoua

Large Firms Spending Millions on Fatca Compliance

Many larger institutions have now spent upwards of $100 million on their Fatca compliance programs getting ready for the July 1 deadline and are likely to spend more, according to Jon Watts, director and head of banking and securities, Fatca at Deloitte New York, who spoke at an *Inside Reference Data* conference in New York on March 18.

"There are still a lot of requirements to come," he said. "This has been expensive, it has taken a lot of time, attention and resources from tax, operations, compliance and risk just to focus on getting to the point we're at today."

While most financial institutions are on their way to Fatca compliance, despite the complexities, some firms won't be ready for the July 1 deadline—not only financial institutions, Watts warned. "Some of the vendors that support a lot of the institutions aren't going to make it either," he added.

Jessica Meek

SIX Service Monitors Instruments Subject to Fatca Regulations

Data services provider SIX Financial Information has launched a new service to help firms comply with the US Foreign Account Tax Compliance Act (Fatca) by identifying instruments that are in scope for tax withholding and highlighting those that subsequently come into scope due to a material modification.

As part of the US anti-tax evasion measure, non-US financial firms will be required to withhold tax at 30% on US-sourced payments to non-compliant accounts. To help firms comply with the withholding requirement, which is expected to come into effect on July 1, SIX has classified the 12 million instruments in its data universe as 'in scope', 'exempt grandfathered' or 'exempt short-term.'

SIX is also harnessing its security events and corporate actions processing capabilities to monitor material modifications. "Based on our existing processing for security events and corporate actions, we compile corresponding checklists for our tax specialist team," says Harald Rudolph, SIX's Zurich-based senior product manager. "If required, they then consult the issuer or the issuer's agent, lead manager, etc., and obtain confirmation [about] whether the grandfathering status is lost or retained, and will flag the instrument in question accordingly."

Nicholas Hamilton

IRS Readies FFI List

The US Internal Revenue Service (IRS) expects to issue its foreign financial institutions (FFIs) list on June 2 for the US Foreign Account Tax Compliance Act (Fatca). On April 2, the IRS announced 19 new intergovernmental agreements (IGAs) were in effect, bringing to 45 the number of countries with IGAs for Fatca compliance.

IDC Offers Withholding Data

Data and pricing provider Interactive Data has launched a service to help its clients comply with the US Foreign Account Tax Compliance Act (Fatca) by identifying instruments that are generating US-sourced income. Interactive Data's service helps firms classify instruments as fully liable for income tax withholding, partially liable or exempt.

Anthony Belcher, Interactive Data's London-based director for Europe, the Middle East and Africa pricing and reference data, explains says instruments that come into scope for withholding because of "material modifications," will be updated immediately in daily files and on-screen views of data under the service.

Virtual Roundtable

Fatca: Ready to Comply?

Inside Reference Data gathers together leading data management professionals to discuss how prepared they are for Fatca compliance, and what the regulation will mean for the data management industry

Are data gathering and integration processes ready for July 1?

Edward Sander, global vice president and general manager, anti-money laundering solutions, NICE Actimize: We don't think the processes are as ready, or as strong, as they could be. Given the business complexity and the uncertainties associated with the Fatca regulation, we're seeing many financial institutions that are deciding to start the implementation process with manual procedures. We note that some are still assessing the operational impact of Fatca compliance, and going through a learning process on their way to implementation. Since this is a new regulation, there are not many "best practices" approaches that are available to be leveraged.

Firms will start evaluating additional technology-oriented automated solutions and processes within the next 6–12 months, as the next regulatory deadlines (including the first report due date) will be approaching. This will allow them to make sure their business processes are well-defined and well-set before committing to more automated integration processes.

Last year, we conducted an industry survey that asked what the most challenging area in Fatca compliance is. And we learned that most institutions were far from ready for Fatca compliance. While things have improved since we took that survey, many of the same challenges are still there for many institutions. Data gathering and integration remains one of those challenges.

Fatca regulation impacts many different divisions (such as legal, tax, compliance and business lines) as well as many different operational processes (onboarding, ongoing, document management and more). So yes, data gathering and integration are a concern—but there are actually bigger and broader challenges to be addressed before the July deadline.

Jacob Gertel, senior project manager for legal & compliance at SIX Financial Information: Our customers need enough time to make IT amendments and implement withholding and reporting mechanisms. We started providing data on the instrument level in late January to address this. We also have the data structures in place to identify entities using the Global Intermediary Identification Numbers (GIINs) and can provide sample data, but unfortunately it isn't possible to deliver live GIIN data before the official release, which is currently scheduled for June.

Based on the information we are getting from our customers, many already have Fatca processes in place, but others are still in the integration process. Part of the reason for delayed preparation for Fatca could be that many financial institutions are waiting to see what, if any, Intergovernmental Agreement (IGA) their government will sign with the US Treasury.

Ravi Vasantraj, global head of banking, financial services and insurance, Tech

Mahindra: This is a mixed bag, and very much depends on the complexity of the financial institution and its current IT framework. Some firms have tackled the issue of collecting, cleansing, merging and then analyzing data and are now moving onto some of the downstream Fatca compliance tasks, while others are only now understanding what is involved and what processes (client on-boarding, remediation, etc.) and systems need to be implemented. What we are seeing however is a move from the tactical compliance solution to a more strategic solution as more information is received about similar regulations coming in the future.

Tim Lind, global head of regulatory solutions, pricing and reference services, Thomson Reuters: This depends on what model practitioners are using. If you are working with an information vendor, who

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has a proven Fatca service, then you will have part of your data gathering requirements resolved. However, the need to integrate and/or upgrade legacy systems is ongoing for many firms. Equally, many firms are still seeking new workflow tools to better screen accounts, search for US indicia, analyze the strength of various data connections within their core client databases and ensure their on-boarding solutions are fit for purpose. For many banks, having access to partners who can provide them with tax services, related risk models and specialist pricing and reference data is essential for them to meet their Fatca obligations.

What is the scope of the demand for document processing and identifier assignment for Fatca compliance support?

Gertel: Financial intermediaries must have due diligence processes in place to meet Fatca compliance requirements, and documentation is a key element. Financial intermediaries must ensure their customers have signed either the W-8 (for non-US customers) or the W-9 (for US customers), as these documents are the basis for the KYC reviews needed to classify customers correctly, especially to clearly identify customers that are "US Persons." Intermediaries have to carefully complete and store this documentation to ensure a proper audit trail, which also means being sure their IT systems are able to record the documentation as well as any subsequent follow-up that may be required.

Vasantraj: Document processing is an integral requirement for the remedial management process of Fatca. Depending on the identified status of the customers, relevant documents such as W8/W9, self-certifications etc., have to be submitted and monitored.

It is vital for financial institutions to focus on trying to automate this remedial process to reduce downstream iterations. Solutions that generate forms automatically based on validated customer information, assign identifiers to link them back to the process on receipt of these forms and generally automate the entire workflow process greatly reduce the pain this obligation causes to the institutions and their customers.

Lind: Demand for onboarding solutions (such as KYC) to assist with electronic reporting, the better management of W-8/9 filings and Fatca-compliant self-certification documents is very high. There is an intrinsic requirement for practitioners to develop efficient systems that can keep records up-to-date, ultimately detect US citizens, dual citizens and those subject to US taxation and on-board customers in a timely and efficient manner. For many firms, these are the services they are outsourcing or seeking third parties to supply. New account onboarding procedures must be implemented for US Withholding Agents, Participating FFIs, and Registered Deemed-Compliant FFIs; withholding begins on US-sourced income payments to non-participating FFIs, non-compliant NFFEs, and recalcitrant account holders.

Fatca also requires foreign financial institutions (FFIs) to register on the Fatca portal, in order to get a GIIN. There has been a delay in registration of FFIs and a full list of applicable entities will not appear until June. When provided, this list will help with identification of eligible FFIs and their related processing.

What conflicts between data sources or stores are emerging that need to be resolved for Fatca compliance?

Gertel: I believe the biggest challenge faced by financial intermediaries in this process is ensuring high availability of customer/counterparty data.

Vasantraj: The data required by a financial institution to comply with Fatca often resides in multiple systems, in multiple formats and are sometimes contradictory. Getting this data formalized into a central database is key to being able to solve not just Fatca, but other tax reporting initiatives that are coming down the road such as AEOI. Having a central 'store' of the required information also facilitates the centralization of Fatca and other regulation compliance across multiple jurisdictions.

Lind: Fatca is inherently a complex regulation, with changing material modification components and model conflicts. These underlying challenges impact the industry's ability as a whole to provide consistent and streamlined responses to the regulation. In many cases, an expert opinion is required to make an informed decision.

Access to Fatca-specific tax services is often required to ensure appropriateness. This currently is something that is not easily automated. Smaller providers and stores do struggle with providing suitable feeds and applicable linkages. Conflicts exist between data sources

Ravi Vasantraj, Tech Mahindra

and stores when it comes to identifying entity types and issuer classifications, instrument and client IDs, the ability to determine the primary jurisdictions of investors/counterparties and their relevant withholding filings.

Overall, institutions need to remediate existing accounts, find connections to US entities with related grand fathered obligations, withhold tax payments, report and process related monies to adhere to Fatca.

Is metadata or cross-referencing of data going to be effective for better supporting Fatca filing and compliance?

Gertel: The FFI agreement states that "A participating FFI's compliance program must include policies, procedures, and processes sufficient for the participating FFI to satisfy the due diligence, reporting, and withholding requirements of this agreement" (FFI Agreement. Section 8, Par. 01), which from our point of view means the metadata and cross-reference data must be well coordinated and accurate to meet the compliance goals. In particular, accurate counterparty identification is critical. Because many firms use a variety of customer/counterparty identifiers, cross-referencing will be an essential element of a Fatca compliance effort.

Generally, we can see Fatca compliance requires coordination between all involved FFI business units to establish sound and sustainable processes and procedures for gathering and maintaining instrument and customer data for accurate reporting.

Sander: Absolutely. There is a strong alignment of the Fatca business processes and the existing AML/KYC procedures that most financial institutions are already implementing, such as the need to collect information at the initial onboarding stage, correctly classify the customer, obtaining the right documents and implement a process of an ongoing review. As such, there is a lot of potential in leveraging existing data as well as existing platforms and business processes to better support the Fatca compliance regulatory requirements.

For example, a lot of the information that is required for a Fatca indicia check is already captured during the onboarding process as part of commercial and AML procedures—such as addresses and phone numbers. Making sure this data is reused for Fatca purposes increases the data quality, reduces the chance of duplicate records, increases the business efficiency and enhances the customer experience.

The key factor for successful Fatca compliance is leveraging technology as much as possible, so the business complexity of Fatca is integrated into an automated system and which avoids prone-to-human-error manual processes.

Interestingly enough, we see many institutions treating Fatca as a withholding exercise separate from their other CDD efforts versus leveraging them. We believe that's an untapped area for synergy in an institution's overall effort for Fatca compliance.

Vasantraj: Yes, not only is it more effective, it is vital! Fatca has specific requirements around identification, classification, withholding and reporting that requires metadata and the cross-referencing of data for effective compliance. Data related to the entity, customers and instruments retrieved from a variety of data sources have to be cross-referenced and cleansed to create a golden copy of records with additional indicators for holding percentage, GIIN, withholding applicable, etc.

Once the data attributes are clearly identified, compliance processes become easier.

Tim Lind, Global Head of Regulatory Solutions, Pricing and Reference Services, Thomson Reuters
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Lind: Better metadata and cross referencing offer institutions an ability to more efficiently manage the inter-linkages between issuers; instruments; counterparties/investors; jurisdictions; grandfathered obligations and any related material modifications. The key here is to have access to reliable Fatca reference data, but regrettably, Fatca implementation has at times been ambiguous. One obvious example is what specific events constitute a material modification.

The IRS has yet to offer a prescriptive and exhaustive list, which has impact on a firm's ability to implement a total codification process to easily identity what data/records are essential to Fatca compliance. If a clear convention is established, then the industry can improve the consistency in the three Fatca pillars of documentation, withholding and reporting.

Q&A

Next Steps

Inside Reference Data asks Jon Watts, director and head of banking and securities, Fatca, at Deloitte & Touche, what still needs to be done in preparation for the US foreign tax rule taking effect July 1

Jon Watts

What Fatca demands still need more attention in the industry?

Financial institutions have a short window for user and integration testing between now and July 1. After then, the industry must focus on customer remediation and reporting. Depending on firms' client mix and which intergovernmental agreement jurisdictions they operate under, significant incremental analysis and work could be required. There's also ambiguity in some countries about how to comply with client onboarding and withholding rules.

What do you see as the most effective system or method of organizing data relevant for Fatca reporting?

Digitizing data from tax forms to make it available for internal data analysis and IRS reporting is crucial. When designing a data model to capture data from tax forms, consider different client relationships that are in play. When defining data models and algorithms, data architects should consider complex hierarchical tree structures that can result from multiple relationship levels of intermediary clients having further underlying intermediary clients. Also, firms should establish data aggregation systems.

What will the next phases beyond July 1 demand of the industry?

Pre-existing customer remediation, reporting, and the controls framework are the next important milestones. Pre-existing remediation will require the upfront structuring of the document solicitation process, including the identification of "*prima facie*" populations, identifying and curing for tax documentation, and preventing multiple lines of business from duplicating contacts with customers for documentation. Firms also have to avoid "opening the hood" repeatedly to add reporting requirements, and should modify onboarding processes. A controls framework is needed to serve as an audit trail proving operational capability for meeting Fatca requirements.

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