# FATCA Compliance Initiation for a Financial Institution

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**The Foreign Account Tax Compliance Act (FATCA) regulations require that foreign financial institutions (FFIs) establish internal controls that will identify clients that are US persons, and that a "Responsible Officer" makes regular certifications to the IRS through the "FATCA Registration Portal" (unless an intergovernmental agreement (IGA) allows for indirect reporting to the IRS via a foreign government).** FATCA regulations require financial enterprises to report information about certain transactions and about certain accounts.

The final regulations may mitigate the burden placed upon FFIs from the extensive customer identification program (CIP) identification or "Know Your Client" (KYC) requirements of FATCA. Like the proposed regulations a year previous, the final regulations include a series of criteria (indicia) and thresholds, albeit modified, for aggregated client balances as a benchmark to determine if further client remediation is needed to determine US status.

FATCA requires all FFIs to choose to register with, and report to, the IRS but for a few limited exceptions, or to be designated as a Non-Participating Foreign Financial Institution (NFFI). Participating institutions must certify compliance in accordance with an electronically signed FATCA FFI Agreement, on an annual basis. By 15 July 2013 the IRS will open its FATCA Registration Portal and the Portal will be closed on 25 October 2013 for inclusion on the 2 December 2013 Participating FFI List. NFFIs (not on the 2 December List) will be subject to a 30% withholding from 1 January 2014 on most US source income, without the exceptions, by example, for portfolio interest and banking deposits.

Though FATCA was enacted more than 24 months ago, there is substantial concern that many impacted compliance departments currently do not have access to sufficient information regarding which sources of the enterprises' income are foreign, which are based in the US, which of their customers are US (taxable) persons and which entities have substantial US ultimate beneficial owners. There is a gap between the deadline expectations stated in the final regulations, in the IGAs signed in the latter half of 2012, and the current abilities of many impacted enterprises to provide this information.

To ensure compliance, enterprises need to make adjustments to client on-boarding and maintenance procedures, information collection and reporting systems, and withholding protocols. Many departments are likely to be affected. Consulting a knowledgeable FATCA advisor will be a critical first step.

The FATCA compliance officer will need to collect information about the types of accounts, account holders and transactions, country locations, and lines of business a specific financial enterprise has in order to give competent and thorough advice to Management and the Board of Directors on how the enterprise may best engage outside FATCA experts and develop a process for a compliance programme before the closure date of the Registration Portal.

The FATCA compliance officer responsible for an enterprise with multiple lines of business in multiple jurisdictions is particularly at risk of missing this critical registration deadline and other important compliance milestones.[1]

FATCA compliance planning requires that the FATCA compliance officer collect data to determine what information is currently available, and review the FATCA requirements with outside FATCA experts to determine what additional information must be collected. Only then can IT consultants determine how best to engage with the enterprise systems to review and collect relevant information.

The impact of collecting this additional information may be substantial. The better the client tailors the data it pulls to provide to the FATCA advisor, the longer the initial budget will stretch throughout the compliance programme setup cycle. While it is important to provide all of the required information, a report containing, for example, a history of all accounts and transactions will be extremely time consuming for the tax advisor and will create unnecessary expense.

The compliance mitigation measures are that accounts falling within specific Foreign Financial Asset (FFA) thresholds need only rely on electronically searchable data. Nevertheless, these burden reducing measures are not extended to all accounts. For example, when the aggregated balance or FFA of a client surpasses USD1 million, FATCA requires a series of manual verifications (non-electronic searches) to determine US indicia when electronically searchable data yields no such results.

Many FFIs operate with banking systems like on-boarding systems, operation and wire transfer systems, compliance and fraud systems as well as the primary core system; however, not all FFIs are created equal. Small participating FFIs will not have the same research, financial capacity or resources to ensure compliance with FATCA in an electronic manner.

Many small FFIs have, maintain or conduct business with US persons or entities, albeit the number of which may be small. Where small institutions "dump" their US clients, these FFIs still need to undertake a FATCA compliance exercise to certify that the institution has no US clients.

FATCA has various provisions in the final regulations that require FFIs to monitor all account activity, not just KYC information provided at account opening or during any "remediation" project. Consequently, the vast majority of all FFIs will be required to maintain, modify and/or obtain bank software to assist in compliance monitoring.

Software integration can be an arduous process and risks are continually present, including: risk of incomplete migration of data; aggregation formulas not functioning as designed; user interfaces not

performing; alerts not designed or modified correctly to ensure all possible ways to ascertain US indicia.

Participating FFIs will inevitably need to enlist the assistance of electronic bank systems or dedicated FATCA systems. Such tasks will require in-depth systems analysis of software systems currently in place, the ability to integrate existing software with new requirements as well as the need for additional software.

Many FFIs may not have requested the information required from their clientele. While most core systems have pre-established fields for many of the basic and general client demographic profile requirements, many may not have the system capacity to obtain, store, and generate the information needed to comply with FATCA.

Data quality assessment will be one of the many challenges FFIs must face to comply with FATCA. FFIs will need to perform complete data quality assessments of information obtained and stored within the many sources of client data.

Various electronic and manual sources provide information to financial institutions (FIs). Some data is fed directly into the core FI system, while other data is obtained from other systems and populates additional forms as needed. With so many possible sources of stored data, the task of a data quality assessment can be a daunting one. Yet, performing a thorough data quality assessment can, in the long run, be a cost-efficient use of future resources and avoid or minimise unfavourable audit results with regulators.

Once the FFI concludes its data quality assessment and determines that the data can provide accurate information, the institution should determine whether the software systems in use are suitable for complying with FATCA. At this point the remediation portion of current client data begins. Because the regulations envisioned these challenges, FATCA only requires accounts to be reported as they qualify based on reportable thresholds unless the FFI wants to report all US account holders or entities with significant US ownership.

For institutions that have never conducted a remediation, it generally requires that the institution revise a determined group or number of client files to ensure that all required documentation of such clients is actually on file and maintained by the institution. FATCA allows pre-existing clients with accounts greater than USD50,000 and up to USD1,000,000 to be searched via electronically searchable records. For clients with accounts over this threshold, the FFI will be required to search non-electronic files if electronic records do not prove to contain any US indicia. In addition, for those clients with accounts over USD1,000,000, the FFI will be required to perform due diligence with the relationship manager of their actual knowledge of the client.

Any remediation can become a lengthy project regardless of how it is structured. Strategic preparation, planning, and dedication must be outlined to mitigate many of the risks involved.

A categorised method will allow the institution to keep track of all searched and obtained data as well as identify what information is missing or not collected. A FFI should conduct a database-wide search for US indicia as outlined in the FATCA legislation: account holder's nationality and/or residence status; account holder's current residence address and mailing address; account holder's current telephone number(s); standing instructions to pay amounts to another account; "in-care-of" address or "hold mail" address for the account holder if no other residence or mailing address is found for the account; and a power of attorney or signatory authority for the account.

Once all data is searched for US indicia, the resulting data can be separated into groups of US individual accounts and US entity accounts. FFIs will then need to sort all identified US accounts by aggregated account balances of all accounts maintained by the same identified US person or entity. Therefore, all systems used should allow for proper aggregation of account balances of similar product type.

For example, FI software should be able to differentiate between demand deposit accounts (DDA) and portfolio accounts, then aggregate balances of similar grouped products instead of a complete regurgitation of entire assets under management. When a product class is identified and grouped, the FFI will need to ensure that the software will identify all US clients that meet specific balance threshold criteria for existing clients. Software should be able to identify and group accounts by: individual accounts over USD50,000, and entity accounts over USD250,000.

It is then vital to conduct another search of the entire database of remaining individual and institutional clients that did not have any US indicia as a result of the electronic data search.

If any account holder maintains over USD1,000,000 yet was identified during the initial data search as being an account subject to FATCA reporting, no further enhanced due diligence is required. Those not previously identified but managing an aggregate balance of more than USD1,000,000 will be subjected to a two-phased enhanced due diligence process. FATCA's due diligence requires a search of all non-electronic files to provide evidence of any US indicia and an inquiry by the relationship manager of their actual knowledge of the account holder. For any accounts resulting in positive identification as having US indicia, the FFI will be required to label such accounts as US accounts and subject to annual reporting.

Once all US account holders or significant entity shareholders are identified, the FFI will need to ensure it obtains all required client data according to FATCA KYC provisions. Such a task will involve contacting the client directly to obtain all needed documentation and information. Although FI software will help this process and reduce the overall burden of manually searching all data, the FFI will need to modify current systems to allow for general searching abilities along with documentation tracking and portfolio changes.

## Compliance costs

Time limitations for the implementation of FATCA regulations requires updated information reporting and withholding at the foreign and domestic FIs. A significant problem centres on compiling and analysing large amounts of customer data and creating new systems to resolve passthru payment issues. FATCA will be expensive for FIs to implement.

KPMG and Deloitte studies indicate that over 250,000 FFIs will be affected by FATCA. The affected institutions will include investment firms, brokers, and banks among other FIs. Global costs of FATCA range from hundreds of millions of dollars to billions. Other studies suggest that the estimated implementation costs of FATCA can amount up to USD235 million per institution.

Some observers have predicted that the cost of compliance for foreign institutions will greatly exceed the tax revenue the United States will collect. One problem is the fact that the amount of monies from financial crimes that will be revealed cannot be determined. The IRS has claimed that over USD10 billion in revenues will be recovered from offshore accounts over the next decade. The IRS has received USD5.5 billion in revenue from its "Offshore Voluntary Disclosure" programme that resulted from the UBS investigation.

Certain FFIs are taking an alternative approach to compliance. Refusing to compile customer data and complying, the institutions are terminating accounts of US persons. Deutsche Bank, Commerzbank, ING Group, Credit Suisse and HSBC have taken this position. These FIs cite the onerous regulations of the United States and contend that FATCA will make the problems worse.

## END NOTE:

1. *330 page Lexis Guide to FATCA Compliance, Author, Prof. William H. Byrnes and Contributor, Jason Simpson, Director, Miami, Global Atlantic Partners. This FATCA Compliance Manual contains three chapters written specifically to guide a FI's lead FATCA compliance officer in designing a plan of internal action within the enterprise and interaction with outside FATCA advisors with a view of best leveraging available resources and budget.*