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Point of View

This point of view is part of an ongoing Investance research initiative into regulatory change impacting the global financial services industry.

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FATCA: An overview

As part of the Hiring Incentives to Restore Employment Act (HIRE) signed into law by President Obama in March, 2010, the U.S. Treasury enacted the Foreign Account Tax Compliance Act (FATCA). The Act requires financial institutions to enhance their due diligence processes and be able to identify US individuals or legal entities that have invested in non-US financial accounts or non-US entities. The Act's objective is to prevent those US individuals or entities from hiding assets and income abroad.

Under the provisions of FATCA, Foreign Financial Institutions (FFIs) and other financial intermediaries will be expected to sign an agreement with the Internal Revenue Service (IRS) and comply with new reporting, disclosure and related requirements. Failure to do so will potentially subject the Institution to US withholding tax of 30 percent on all payments it receives. Similarly, US entities of the FFI are required to enforce the FATCA requirements on their clients. Individual accounts of the FFI, whether U.S. or Non U.S., that fail to provide FATCA required additional documentation to the FFI, would be considered recalcitrant. In this case, the FFI will be required to apply a 30% deduction to any withholdable payments made to those accounts

An FFI should decide to enter into an agreement with the IRS by mid 2013 to ensure sufficient time to become a Participating FFI by January 1, 2014 when some withholding will come into effect

The FATCA scope extends beyond institutions and high net worth accounts. The rules will affect thousands of clients who will need to be informed that account details might be disclosed to the IRS, raising issues of privacy and account protection potentially stretching across multiple jurisdictions.

1 FATCA Key Impact and Considerations

The ability to align all the key stakeholders across the entire organization (Legal, Tax, Operations, Risk, Technology) is paramount to successfully comply with FATCA. Key considerations include:

1. **Timing:** Although, the provisions of FATCA apply to payments made after December 2012, the IRS took under consideration that financial institutions would need more time to implement the required changes. As such, they have outlined a set of transitional rules that do not require any FATCA related withholding until January 2014
2. **Entities:** FATCA will impact any business that has custody, receipt or release of any withholdable payment. Such payments include US sourced fixed and determinable annual or periodic income (FDAP) and proceeds from the sale of assets that generate US sourced interest or dividend income
3. **Front - to – Back Impact:** FATCA will cut across silos and require updates and enhancements to all areas of the Firm’s data resources, reporting, compliance and ongoing new account information gathering efforts
4. **Data:** FATCA requirements go much further than current KYC/AML standards and will require firms to identify key gaps in their current customer data quality. Identification of these gaps and impacts to related entities will be crucial in preparing for FATCA compliance
5. **Cost and Mandate:** Although various foreign countries have voiced opposition to FATCA, it is coming and it will require an investment in systems and operational processes. By being proactive in assessing and analyzing the impact of FATCA, firms will ensure a timelier and cost effective FATCA compliance solution.

2 Preparing for FATCA

The detailed rules and provisions of this Act are being developed and final regulation is planned for the summer of 2012. The IRS however, has issued preliminary guidance in the form of “Notices” (Notice 2010-60 in August 27, 2010; Notice 2011-34 in April 8, 2011; & Notice 2011-53 in July 25, 2011). Although, these notices do not have any authority, they are a very good indicator of direction the IRS is taking in its implementation of the Act.

Summer 2012: Expected final regulations from the IRS and Treasury

The time for action is now! Detailed systems analysis and process extensions to enable thorough identification and capture of account information for FATCA compliance will take time. Many firms have invested in studying the implications of the Act and are pro-active in planning for enhancements in Operations and Technology.

1. Entity Analysis: Detailed analysis and identification of all group entities that will be impacted. This will include implications of FATCA compliance against local regulations and FATCA compliance type. Payments for Insurance products for example may not follow the same rules as FDAP type payments
2. Functional Approach: Determination of agreement with IRS or changes to the business model. Communication to internal stakeholders and external notification to clients regarding FATCA information requirements. Review of existing processes and measure of IT system capabilities to identify U.S. accounts or US Entities with greater than \$50,000 (aggregated), and withholding. Analysis of current management reporting needs to adhere to both FATCA and internal audit compliance
3. Gap Strategy: After identifying areas needing process enhancements, a strategic roadmap should be created identifying key stakeholders, timeframe, data and IT needs. The opportunity for a firm to go beyond FATCA and implement all around compliance, KYC, AML best practices is large. Future customer data mining capabilities could be greatly enhanced through these process improvements

July 1, 2013: FFI Applications become effective

3 FATCA Opportunities

While the onus will be on compliance and reporting, FATCA does represent a strategic opportunity for firms to embark on a holistic review of their current data quality and client communications. By creating and implementing an efficient communication strategy, firms can renew out dated contact information and strengthen relationships.

Improvements to data quality could also provide the opportunity to deliver enhanced management reporting and identify potential operational upgrades.

Technology upgrades to account, calculate, withhold and report represent an enhancement across multiple business units. Proper analysis, requirements definition and testing will be crucial to yield the most cost and data efficient compliance and future flexibility.

Jan 1, 2014: FATCA withholding begins (limited to US sourced FDAP on payments to new accounts)

Communication to clients will be a key element in every firm's FATCA compliance strategy. By taking a hard look at current account and communication processes, firms can take this opportunity to update client information and train internal employees regarding account opening and maintenance.

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