FATCA

Are we having fun yet? FATCA tsunami engulfs AML/CTF

By Anthony Quinn

Anyone who has been involved in designing, building, deploying or ultimately managing an anti-money laundering and counter-terrorism financing program (AML/CTF Program) and has lived to tell the tale will agree on at least one thing – what appears to be relatively straightforward in theory is a great deal more complex to implement in practice, such is the diverse and multifaceted nature of financial service businesses today.

Six years on – and with many reporting entities still refining, tweaking, redesigning and enhancing their AML/CTF Programs – these same bodies are staring down the barrel of a potentially larger and more complex compliance program called the Foreign Account Tax Compliance Act (FATCA). Since many reporting entities have morphed related functions for combating financial crime – such as AML/CTF, Fraud and Sanctions – into a central function, it is likely that the responsibilities for driving FATCA within many organisations will fall on the same shoulders.

For the uninitiated, FATCA was passed as legislation on 18 March 2010 and is aimed at addressing tax evasion by U.S. taxpayers holding investments in offshore accounts. Since enacting FATCA, the U.S. Government has issued three notices[1] and on 8 February released the draft FATCA regulations which go a long way in addressing industry concerns raised in the earlier notices. The FATCA draft regulations[2] are subject to industry consultation which expires on 30 April 2012, and will shortly be followed on 15 May 2012 with a public hearing. Final FATCA regulations are not expected to be issued until the northern summer of 2012.

For background on the core components of FATCA, please refer to *The slow steady march of FATCA* in the August 2011 edition of this magazine and the November AFMA webinar *FATCA & AML/CTF – The hard yards of implementation*.

The purpose of this article is to provide key insights for those tasked with implementing FATCA by providing a summary of the major challenges most FFIs will face in meeting the requirements, in addition to highlighting similar challenges faced during the AML/CTF Program implementation from which we can learn.

We will look at implementation issues and challenges in the following areas:

- Governance and oversight;
- Customer on-boarding;
- US account discovery; and
- Withholding and reporting.

Governance and oversight

If the estimates being put forward by some major banking institutions are to be believed, FATCA is expected to cost many organisations tens if not hundreds of millions of dollars each to comply with the withholding and reporting obligations. Whatever the true dollar figure, one thing not in doubt is the size and

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complexity of the FATCA Program, which in many respects will be a much larger undertaking than the AML/CTF Program while at the same time traversing much of the same business processes.

As with AML/CTF, the starting point is ensuring that the board and executive management within your organisations are fully engaged and truly understand the implications of FATCA on the business, in all countries where the business operates. The Inland Revenue Service (IRS) are also aware of this and expect FFIs to appoint a 'FATCA Responsible Officer' who has a single point of accountability within the Financial Institutions within the FFI and is ultimately responsible for *"certifying that the FFI has complied with the terms of the FFI agreement"*.

As this role comprises many of the same responsibilities as the AML/CTF Compliance Officer (for example, establishing the compliance framework and overseeing the set-up and monitoring of internal controls to monitor compliance breaches) FFIs should start to consider the governance structure for FATCA alongside other risk disciplines such as AML/CTF.

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The first duty of the FATCA Responsible Officer will be to raise awareness of the implications of FATCA with the board and senior management, as well as across the rest of the organisation. The best way to do this is to start conducting an impact assessment of the effects of FATCA on your business by considering the implications from a financial, strategic, operational, technical, legal, risk and compliance perspective; and to engage the business heads responsible for these functional areas in the design or the FATCA compliance framework.

As with all large-scale transformational change initiatives, there will be countless decisions to be made that will influence the design of the FATCA Program globally. At the outset, FFIs will be required to make some fundamental decisions that will call for thought, discussion and the backing of the board. For example:

- Will the FFI sign the agreement or divest U.S. revenue streams?
- Will the FFI continue to offer products and services to U.S. citizens?
- How will the governance structure for FATCA compliance align with other risk initiatives?

Just as with AML/CTF, management will not be able to see any business benefit in FATCA and most senior management teams will be looking for FFIs to meet the compliance obligations in the most cost-effective and efficient manner.

Customer on-boarding

The major similarity between FATCA and AML/CTF in the requirements is the impact on customer information processes. FATCA will expand the data collection and verification requirements during account set-up, as well as during the life of the relationship with the client. Many of the KYC data requirements that FATCA will require FFIs to collect are not minimum requirements under the AML/CTF Customer Identification Program (CIP). In fact, many organisations shied away from adding any additional KYC fields related to an individual's place of birth, country(s) of citizenship or country of residence for tax purposes, through fear of exceeding what their peers were doing, or of being accused of being discriminatory or crossing an invisible privacy line.

Not only will additional KYC data be required for any new clients after the FATCA commencement date of 1 January 2013[3] but clients will need to be expressly asked to provide consent to share financial account information with overseas tax authorities.[4] If clients see this as an impost and forget (or refuse) to tick the waiver flag, many Participating FFIs (PFFIs) can be expected to terminate the relationship with the client. This throws up a number of practical issues. Not least, if an FFI opens a new account for an existing customer but they refuse to sign the consent to disclose: what is the impact on any existing accounts – particularly if they fall into a category where it might be contractually impossible to terminate the relationship.

While the collection of a few additional items might seem on the surface to be a simple exercise of updating the CRM system, once organisations scratch a little deeper they often discover a minefield of issues similar to those experienced during the implementation of CIP within AML/CTF Programs.

The types of issues that FFIs should consider when making changes to customer on-boarding systems and processes will need to be examined in a holistic way, and will require future-proofing against FATCA copycats from other countries. For example, if applications are received online or via good old-fashioned paper, what changes will need to be made to systems and client collateral to capture the required information? If the FFI uses online account-opening forms (which most do) then what interfaces need to be built between the front-end website and the downstream CRM system? This is further complicated when considering additional downstream impacts on product/accounting systems that will be used for withholding and reporting, which will likely be driven from the U.S. indicia flags in upstream client data systems.

Any reporting entity that has successfully implemented straight-through electronic verification (EV) systems and processes for AML/CTF and wishes to continue to use these for FATCA might be required to enrich the verification checks by verifying records from U.S. data sources, which may or may not be available through their current EV provider.

The other similarities between FATCA and AML/CTF CIP occur in respect to identifying the beneficial ownership of entities, where the Ultimate Beneficial Owner (UBO) is a U.S. taxpayer. Many organisations have already met this requirement for AML/CTF, as UBOs must be subject to enhanced customer due diligence under AML/CTF. However, here is the rub: the cut-off threshold for determining who ultimately owns and controls an entity under the AML/CTF Act is set at 25 percent whereas for FATCA this threshold is set lower, at 10 percent.

Organisations are therefore faced with a decision: either run parallel processes for AML/CTF and FATCA, at different thresholds; or align the threshold to the lower common denominator, which will ultimately increase the amount of look through required for company and trust customers. The draft FATCA regulations may provide some room to manoeuvre as Treasury make the point that FFIs can rely on existing AML/CTF proce-

dures, but also state that FFIs general identify 'substantial beneficial ownership' at 10 per-cent, which is not the case in Australia or New Zealand.

For legal entities, there are also additional KYC fields that are required to be collected, for example, whether the nature of the business activity is 'investment related'. While with AML/CTF, reporting entities would likely have started to capture the nature of the business activity, it is likely that most would have done so in a free-format which makes it difficult to determine the exact nature of the business activity and whether it aligns with the FATCA meaning. This issue will impact the ability of FFIs during the U.S. account discovery process, which we will look at next.

What are U.S. indicia?

- Known U.S. account holders
- U.S. place of birth
- U.S. address associated with the account (residential, mailing, business, PO box)
- U.S. telephone number
- Hold mail or care of address as the sole address for an account
- Persons with a Power of Attorney or Authorised Signatory status over an account with a U.S. address
- Standard Settlement Instructions to transfer funds to a U.S. bank account
- Payment instructions are received from a U.S. address

There are other indicators that could be used – will you go above and beyond?

- U.S. green card holder or lawful permanent resident (i.e. passport/ nationality details)
- Frequent transfer/receipt of funds from a U.S. country or territory
- Payment instructions from U.S. phone or fax numbers
- U.S. email addresses from U.S. internet service providers (i.e. AOL)

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U.S. account discovery

FFIs are likely to experience significant challenges and issues in conducting electronic data searches for existing clients. This requirement to retrospectively remediate historic account information differs from AML/CTF in that under FATCA there are no favourable grandfathering arrangements.

FFIs would have been relieved to read that Treasury have abolished the previous requirement for enhanced scrutiny of accounts that fell under the definition of "Private Banking / Wealth Management" accounts, instead replacing this with an increased threshold of >=USD$1m for individuals and entities.

High-value accounts will be subject to 'electronic searches' for U.S. indica[5] but the significant increase in threshold will undoubtedly reduce the number of accounts that will be subject to 'electronic searches' or 'paper based' reviews and consequently will reduce the overall cost of compliance.

The draft FATCA regulations have scaled this obligation back further and state that 'paper based' reviews may not be required if the FFIs electronic searches provide adequate information. Where 'paper based' reviews are required this has also been moderated to include only recent data, as opposed to every paper document that an FFI might have on file.

With this in mind, FFIs should proactively begin to examine client account data and look to close out dormant or inactive accounts prior to the 'data cut' date. This could potentially reduce the amount of accounts that fall into scope for pre-existing account remediation.

The initial questions that FFIs will need to examine in conducting this review include:

- How many systems does the FFI have (globally) that store client details?
- What data do current systems record that will likely yield U.S. accounts in the electronic searches?
- What search criteria would be used – minimum or additional?
- How many accounts would be subject to a paper-based review?

Any accounts identified as having one or more U.S. indicia must be classified as 'potential' U.S. accounts. These account holders must be subject to additional follow-up which involves collection and/or verification of additional information (e.g. W8-BEN, W9 or statutory declarations etc.) which is dependent on the nature of the U.S. indicia identified. For example, if a U.S. place of birth is identified but the client insists that they are not a U.S. citizen, a statutory declaration is required for the client to confirm the reasons they do not hold U.S. citizenship (e.g. it may have been renounced).

This will require a process not too dissimilar to remediation of customer records or enhanced customer due diligence processes for AML/CTF, where additional information must be captured, documentation must be collected, systems updated to reflect client responses (or lack of response), product systems flagged for withholding/reporting, and account closure for long term recalcitrant accounts.

Furthermore, Private Banking/Wealth Management (PB/WM) accounts that reveal U.S. indicia, where the relationship manager knows that the account holder is a non-U.S. taxpayer (e.g. many people own second homes in the U.S. but may not be U.S. taxpayers), must provide a written attestation from the relationship manager, effectively signing off that the client is not caught under FATCA. FFIs must consider how they will collect, track and record this signoff process.

The final step will be to conduct an ongoing review of all accounts that may have escaped this process (i.e. accounts that were less than US$50k prior to the cut-off date but are now higher) or were not subject to the same degree of review (i.e. normal account holders that open PB/WM accounts etc.).

U.S. account discovery for entities

The steps for identifying U.S. taxpayers who own or control companies/trusts are similar to those of individuals. Firstly, known U.S. accounts must be identified. Secondly, companies that were incorporated or registered in the U.S. must also be flagged as U.S. accounts. Finally, searches are to be conducted to establish whether the entity is an FFI – appropriate search criteria must be considered.

For example, where the 'nature of business activity' has been collected as additional KYC information under AML/CTF an assess-

ment will be required as to how effective the capture process has been. If it is not sufficient to identify all 'financial' businesses' then the FFIs will need to define key word search criteria (e.g. planner, adviser, finance, broker) to apply to this and other fields (e.g. company name). Pre-commencement customers may never have supplied business activity information making this kind of key word search necessary for that class of customer.

Next, FFIs must identify if the 'financial' institution is operating or not – which should be straightforward if the utilised CRM systems hold ABNs, ACNs or ABRNs. This data would exist for new customers but not necessarily for pre-commencement customers. The next step is to identify any individuals that are UBOs (defined as greater than or equal to 10 percent of the issued share capital) of an operating, financial entity and then conduct individual U.S. indicia searches on those persons. Few FFIs will hold enough information about these individuals to make this possible without direct contact with the individuals.

There are myriad challenges in conducting U.S. account discovery searches – not least the fact that most organisations do not have a 'single customer view' in Australia, let alone globally, effectively duplicating the searches and tracking of accounts. The ease with which this obligation will be met depends on how data is already classified in CRM system(s) and how searchable the data is. It is not inconceivable to anticipate that FFIs with poor U.S. account discovery capabilities could be required to enrich the data that is collected and stored, such that ongoing U.S. indicia searches can yield greater results.

> As with AML/CTF, the implementation of FATCA will be a long journey – a marathon, not a sprint.

Withholding and reporting

FFIs would also have been pleased to read that in recognition of the issues and concerns raised around the ability to modify systems and procedures to accommodate withholding and reporting, the U.S. Treasury have made a number of significant concessions in respect to the scope and timing of the reporting requirements. Whilst reporting requirements commence on 1 January 2014 (for the 2013 U.S. tax year), the data requirements are initially basic (name, address, Tax identification number, account number and balance) and expand incrementally from 1 January 2016 to also include income and withdrawals and from 1 January 2017 to include gross proceeds (including broker transactions). This essentially defers the more complex reporting by two years from the original date of 1 January 2015.

Another major concession is that reporting is permissible in local currency or U.S. dollars which will greatly reduce the cost of multi-currency reporting, however, the reporting period for U.S. tax years will still need to be followed which may prove burdensome for FFIs (like Australia and New Zealand) that have local tax reporting years outside these times.

Another significant announcement includes the opportunity for FFIs and NFFEs operating in "FATCA Partner" countries to collect and report tax information to the local tax authority, as long as the local tax authority has signed either, an Income Tax Treaty Agreement, a Tax Information Exchange Agreement or other type of agreement with the IRS.

A joint statement was also issued by the U.S. Treasury Department that signified that government-to-government discussions have started between the U.S. and France, Germany, Italy, Spain and the United Kingdom to reach a mutually beneficial outcome in respect of cross-country tax information sharing. Many other countries, including Australia and New Zealand, were notably absent from this announcement but the IRS indicated its ongoing commitment to reaching similar arrangements by stating *"the IRS will continue to engage with interested stakeholders, including foreign governments, in connection with finalising these proposed regulations regarding the efficient and effective implementation of FATCA"*.

What should FFIs be doing now if they haven't already started?

Many proactive organisations have already started to prepare for FATCA by actively engaging via industry associations to submit responses to the IRS based on the various notices that the U.S. Treasury Department have issued. In addition, many have started to conduct or have already completed a detailed impact assessment.

For FFIs that haven't started preparing for FATCA there are a number of things that should be initiated including:

- Calculate the exposure to U.S. sourced income that is potentially taxable;
- Determine which products fall under the definition of a 'financial account';
- Determine which products earn U.S. sourced income;
- Determine which current systems store client data (globally) that are 'electronically searchable';
- Identify the scope of the accounts that will potentially require a paper-based review based on the >=USD$1m threshold;
- Determine which current systems are used for the calculation of withholding tax and/or AIIR;
- Conduct a detailed impact and gap analysis across the organisation (globally); and
- Mobilise the project team to plan the scope and approach, and document an implementation roadmap

As with AML/CTF, the implementation of FATCA will be a long journey – a marathon, not a sprint – but the 1 January 2013 commencement date is only 11 months away and the breadth and complexity of changes required is significant.

AFMA will be running a series of workshops entitled *Implementing FATCA* which will examine the potential impact of FATCA in more detail, to start you thinking through the likely implications for your organisation so that you can start to raise awareness and prepare to meet the FATCA challenge. ■

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REFERENCES:
[1] Notice 2010-60, Notice 2011-34 and Notice 2011-53
[2] Draft FATCA regulations – (121647-10)
[3] The commencement date for FATCA is 1 January 2013, which is the date that the IRS will start accepting applications from FFIs. The close date is 30 June 2013, after which if FFIs have not signed they will be considered non-participating. It is likely that most FFIs will leave until the last minute hence the start date 1 July 2013. There is therefore is a six-month window in which to actually start.
[4] This obligation would not apply if an inter-governmental agreement to share financial information is established. The U.S. Treasury announced 5 partner countries – France, Germany, Italy, Spain and the United Kingdom, so other Governments are likely to follow suit.
[5] Meaning indications that the account holder may be a U.S. taxpayer