

The facts on FATCA

Prioritize, plan and prepare







If we take a look at financial institutions today in the context of FATCA – the Foreign Account Tax Compliance Act – while some companies have already begun taking steps toward compliance, other companies have not yet begun to consider it. While recession fears continue and global markets remain volatile, the time to prepare your company to comply with FATCA has arrived.

FATCA is a US tax law, passed 18 March 2010, designed to prevent US taxpayers from avoiding tax on their income by investing in the US through foreign financial institutions (FFIs) and offshore investment vehicles. FATCA represents a significant change to the rules governing cross-border payments and ultimately will have far-reaching consequences. Although discussion continues around many of the specifics for FATCA compliance, and additional guidance will be issued, one point remains immutable: FATCA is law.

Defining the participants

FATCA applies to and defines financial institutions as entities that:

- ▶ Accept deposits in the ordinary course of a banking business
- ▶ Hold financial assets for the accounts of others as a substantial part of their business
- ▶ Are engaged in the business of investing, reinvesting or trading (broadly interpreted)

Generally speaking, FATCA requires these financial institutions – both US and non-US – to classify all their account holders according to three sets of criteria: (1) as US or non-US; (2) as individuals or entities; and (3) entities as financial and non-financial. Foreign financial institutions (FFIs) must enter into agreements with the IRS to identify US accounts and report certain information about those accounts on an annual basis, or suffer a thirty percent withholding. US financial institutions (USFIs) are also required to report certain information to the IRS about substantial US owners of non-financial foreign entities

(NFFEs). Although the guidance and specific regulations have yet to come, insurance companies with cash-value products will likely be classified as financial institutions as well.

The biggest challenge in this new regime will be with regard to classifying accounts under FATCA. The sheer volume of information and data that must be compiled and reviewed for adequate classification, understanding where the data resides, and knowing whether and if the diverse sources are sufficient to make the required classifications and can be used for reporting will be daunting. Some financial institutions will have to rely on a variety of sources in their front and back offices for customer and investor data. While many institutions may have the required information somewhere in their records, the records themselves are likely to be documented in different languages, housed in disparate systems (or in paper files) and run on separate applications that may or may not be linked in the technology architecture.



Dissecting the components of FATCA

There are three fundamental components to FATCA compliance: (1) identification and documentation; (2) reporting; and (3) withholding. The scope of each of these elements is far-reaching and potentially complex, but manageable with the right program in place.

Identification and documentation require an analysis of the customer base and likely process changes. This initial phase is where the lion's share of the work is required as it encompasses due diligence for both existing and new accounts. Furthermore, financial institutions will need to assess their company structures and legal entities to classify them for FATCA purposes as "financial institutions" or "non-financial foreign entities." In addition, USFIs must assess accounts held by foreign entities to identify potential indicia of US status. They must react accordingly, creating

new processes to assess all new accounts opened by foreign entities. FFIs must also assess existing accounts held by foreign entities and existing and new accounts held by individuals to identify potential US ownership. An FFI's files must be reviewed and data collected to verify the identity of US citizens and tax residents with such information as place of birth, citizenship and tax identification number (TIN).

Moreover, IRS Notice 2011-34 requires that the chief compliance officer or other equivalent-level officer of the FFI certify to the IRS when the FFI has completed certain procedures for its pre-existing individual accounts. The chief compliance officer will want to be comfortable that these procedures are fully and reliably executed before he or she signs the statement. The existing files and documentation set the framework for initial FATCA compliance,



as well as ongoing compliance and monitoring, so the onus on the management of this part of the process is significant. It will include several key activities:

- ▶ Legal entity analysis to determine the impact of FATCA by assessing and identifying the internal organizational structure, since FATCA may not be applicable to all legal entities of a financial services firm (or may apply differently to certain entities)
- ▶ Client onboarding and customer identification to locate and analyze the availability of customer information, evaluate data integrity, determine jurisdiction and governance, and assess current know your customer (KYC) and other processes and systems that support new client information
- ▶ Gathering customer and counterparty data is the key source of information for FATCA compliance. This requires

determining the consistency of customer data within and perhaps across legal entities, differentiating the forms of information and identifying possible legal impediments in one country or another to collecting or sharing information

Reporting requirements will likely call for some data that financial institutions do not currently collect or store, which, in turn, will necessitate significant changes to existing systems. Key for financial institutions will be to assess the technological constraints of current systems in order to build and sustain an annual reporting model to cover account balances and gross payments for all US accounts.

Withholding requires identification and analysis of current business payment processes and systems architecture

and understanding of the procedure for withholding on in-scope payments. This is the visible “tip of the iceberg” when it comes to the potential financial impact of FATCA. The backstop for FATCA’s customer identification and information reporting obligations is the imposition of 30% withholding on payments to financial institutions and certain other customers and counterparties that do not comply with FATCA. In order to be compliant, a financial institution must be able to withhold when necessary. The IRS and Treasury can hold an institution liable for any tax it should have withheld if withholding is not done properly. At the same time, erroneous withholding on a payment or counterparty can have serious implications for credibility, reputation and legal risk.





Bridging the gap between urgency and action

IRS Notice 2011-53 describes phase-in timelines beginning in 2013 for implementing the requirements of FATCA. This guidance provides a new timeline beginning 1 July 2013 for FFIs, but USFIs are still subject to the original one, beginning 1 January 2013. An implementation project with dual deadlines, particularly one at a financial institution with a global client onboarding system, could create quite a challenge. To meet these new deadlines, institutions should begin to deliver the key operational and technology initiatives for global compliance. Budget approval for 2012 systems projects already may be required.

The FATCA regulatory process is not static or complete and will continue to evolve potentially up to the effective date. It may be this fluidity or the

perceived lack of clarity regarding the final FATCA requirements that is giving rise to a common challenge among financial institutions: when to get started. Equally perplexing is the daunting amount of work to be done and uncertainty about where to start.

Simply put, your next steps fall into three primary categories: **Prioritize. Plan. Prepare.**

Ernst & Young LLP can help. The worldwide Ernst & Young organization has a global roster of professionals with considerable experience working with clients in the financial services industry and a well-honed understanding of the implications of FATCA for your businesses, as well as your tax, IT, operations and risk functions.



Prioritize

Despite the recent changes to phased-in deadlines and the seeming flexibility in some areas, meeting compliance deadlines beginning in 2013 requires a significant amount of change in a limited amount of time. To help our clients reach that goal, we have developed a clear methodology and tested approach for identifying the strategic options for FATCA compliance and prioritizing initiatives based on their regulatory certainty and complexity to implement.

Pairing our market-leading data analytics approach and proprietary tools for analyzing large volumes of customer and product data, we can help you gain a clearer picture of your key external dependencies: what information is readily available from your existing source platforms, what has

to be collected, and what response time will be required for your compliance with additional documentation requests. With an understanding of the gaps in your current processes and systems, we will work with you to determine the critical activities that must be accomplished or initiated by 2013 and what projects can be deferred. And since remediation may be necessary to enable your systems to provide the requisite information for compliance, we can help you evaluate the most cost-effective options and the timing for bringing them on line.

We can also help you identify any pressing issues or considerations that should be brought to the IRS or Treasury, assist you with these conversations and to give voice to your concerns.



Plan

Regardless of the size of your organization, you will want an actionable plan for FATCA readiness that you can apply enterprise-wide. Part of our approach includes conducting hands-on workshops that will help you assemble and educate your stakeholders, mobilize interest and understanding throughout the organization and gain buy-in where you need it to meet critical deadlines and establish performance milestones.

For many FFIs and multinational investors, one of the critical issues that will arise is dealing with restrictive cross-border customer data-sharing and privacy laws, which could limit a financial institution's ability to comply with FATCA's requirements and prevent an enterprise-wide view of client information. Moreover, you may have limited mechanisms for identifying

the global scope of multiple client relationships or current processes that don't support global consistency in collecting and maintaining client/counterparty reference data.

As a firm with access to a global network of knowledgeable tax and advisory professionals connected by common technology, Ernst & Young LLP can help you manage and coordinate electronic searches for disparate data. We have the experience, the know-how and the tools to help you assess your data for accuracy and completeness across business units and geographies. We will work closely with you to develop your FATCA footprint, which includes an assessment and implementation plan that factors in essential involvement from IT and its input for data and process changes.

Prepare

FATCA will touch more than your key stakeholders and IT departments. It may require a change in your fundamental business model. And it certainly could have an impact on your client base. That makes communication an essential element in the new FATCA regime. The messaging within your enterprise and throughout your client roster can be complex and technical. Arriving at and delivering the right message will be an important and potentially time-consuming activity.

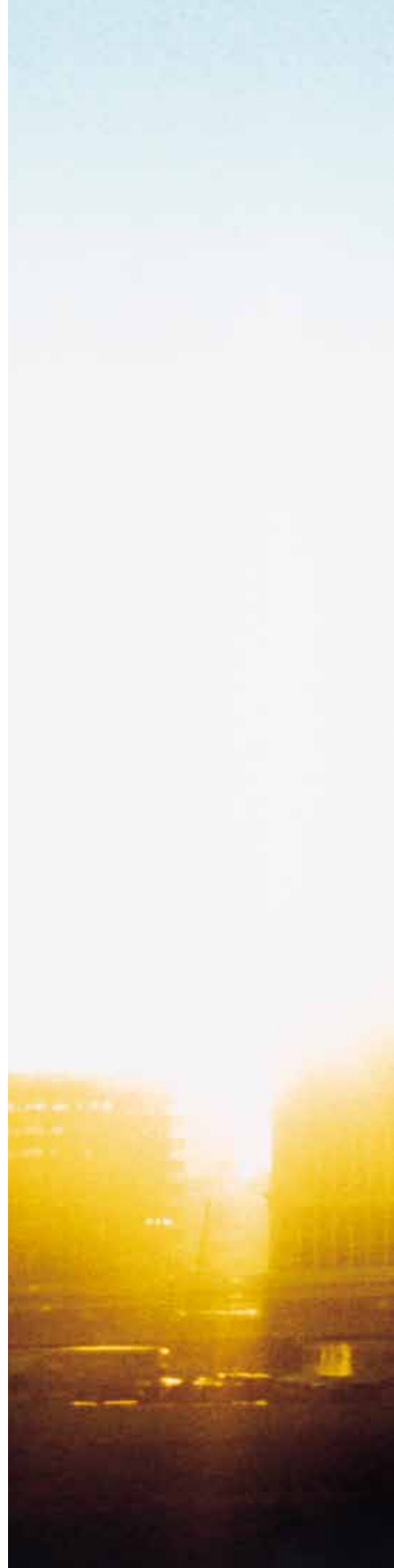
Because we work with companies throughout the financial services value chain as well as companies in a broad range of industries, we can leverage our lessons learned and insights gained across this broad spectrum. That will include tailoring your message to meet your varied businesses and clients and formulating on-point responses for addressing potentially adverse client situations.


Why start now?

Whether your company includes FFIs or USFIs or both, it must be ready to comply with FATCA in 2013. Therefore, existing systems and processes must be evaluated, modified (or new ones developed) and tested during 2012. For those on a calendar-year budget cycle, funding requirements must be addressed soon. Pervasive technology, data and process changes could take 18 months or more to complete. Starting now will provide you with time to flexibly adapt to the worst case scenarios in an orderly and efficient manner. Implementation costs can be better controlled and implementation risks reduced. You will have adequate time to analyze the suitability of technical solutions and resolve issues prior to the go-live date.

The earlier you begin FATCA readiness – in a controlled and well-governed way – the more likely the implementation and, ultimately, the new FATCA processes will be fully compliant and run effectively and efficiently.

Ernst & Young LLP's FATCA services support both the preparation for and the implementation of FATCA requirements for companies across the global financial services spectrum, including banks, brokers, insurance companies, custodians and asset managers. We can provide the level of services required by your group, ranging from full program support to ad hoc technical advice.





Before anything else,
preparation is the key to success.

Alexander Graham Bell

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