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Impact of FATCA on financial institutions

Capital markets centre of excellence

VIEWPOINT

FATCA overview

In a bid to combat tax evasion by US citizens using offshore accounts, the United States government enacted the Foreign Account Tax Compliance Act (FATCA) into law on 18 March, 2010. The act imposes a penalty of 30% withholding tax on US source income unless financial institutions enter into an agreement with the Internal Revenue Service (IRS) and report their US customers. It requires Foreign Financial Institutions (FFIs) to register with the IRS and report information about US account holders either directly or through the home country tax authority. It also requires Non-Financial Foreign Entities (NFFEs) to disclose the identity of their US owners to the IRS.

Impacted institutions

Any bank or financial institution invested in the US market for its customers' accounts or for its own account; and which is part of a group which invests in the US market for its customers' accounts or for its own account will be affected by FATCA.

FATCA impacts retail and commercial banks as compliance requires enhanced due diligence to:

- Identify customers as US nationals, foreign nationals or recalcitrant
- Capture FATCA attributes when onboarding new customers
- Review e-documentation
- Mine indicative data of existing accounts within prescribed timelines

In retail banking, account opening, transaction processing, tax calculations and reporting will be affected with the implementation of FATCA. Identifying and analyzing the affected applications will also require a huge effort as FATCA requires the aggregation of various accounts across same customer.

In corporate banking, the effects will be similar to that of retail banking. But identifying and analyzing the substantial owner details and the 10% shareholding part will be time consuming, and will call for sophisticated data analytical tools.

There are some significant FATCA implications for brokers, custodians, asset and portfolio managers. While the impact and requirements for client identification would be similar to other FFIs, these participants will need to have enhanced systems to monitor account transactions in capital markets for any potential withholding and reporting. The business rules (concerning FATCA governance) would differ on the basis of the nature of products that are traded.

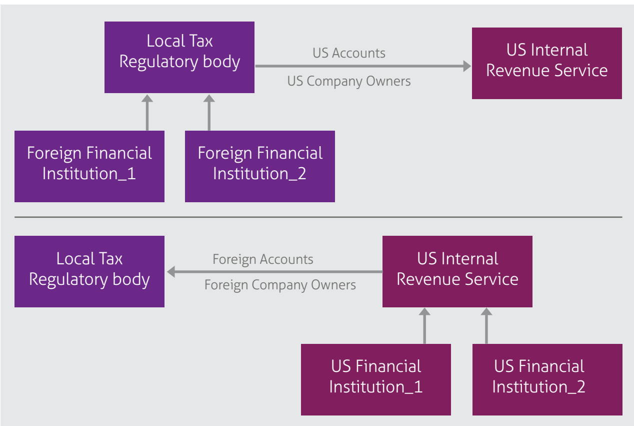
Impact of FATCA on the fund management industry will be the hardest. Asset management companies will be impacted in the areas of client origination, beneficial owner and recipient identification, singular client determination, residential / domicile determination, asset categorization, and NAV calculations and payouts.

Investment banking firms will have to enhance systems to capture additional data for standard report generation in information exchange model, have five year paper document review and account charging for withholding.

Brokers / dealers should design future-state operating models and implementation roadmaps and identify the functionalities of technology systems that will need to be updated for FATCA compliance.

Intergovernmental Agreement (IGA) between the US government and 80 countries

The US Treasury Department has introduced the concept of IGAs as a means of reducing the impact of FATCA provisions on foreign financial institutions.
This implies that it requires reciprocal exchange of information under bilateral tax treaties.



Key FATCA implementation challenges

The implementation of the FATCA legislation poses significant challenges to the banking and financial services industry. They include:

Enhancing operational procedures: Impacted institutions will have to re-consider their procedures specifically around client onboarding since all checks and balances have to be put in place in order to identify a US resident at the time of onboarding.

Insufficient account information: The way in which institutions are recording and storing client and account data may not be adequate enough to identify the data that needs to be reported to the regulators. In order to remedy this situation, an extensive data cleansing exercise may have to be performed.

Lack of central customer data: Very few institutions have all client information readily available at a single place. Usually data is scattered across multiple product and region-specific data stores. Synergizing the data together to make the required determinations with respect to account holders will be a significant task.

Inadequate knowledge: FATCA being an exhaustive regulation, the impacted institution's staff may not have thorough knowledge about the nuances of the regulation. In most cases, such firms will have to look for external help to decipher the regulation and identify its impact on their business procedures.

Short time-frame: Implementation requires immediate focus on critical tasks to be completed within a stringent deadline.

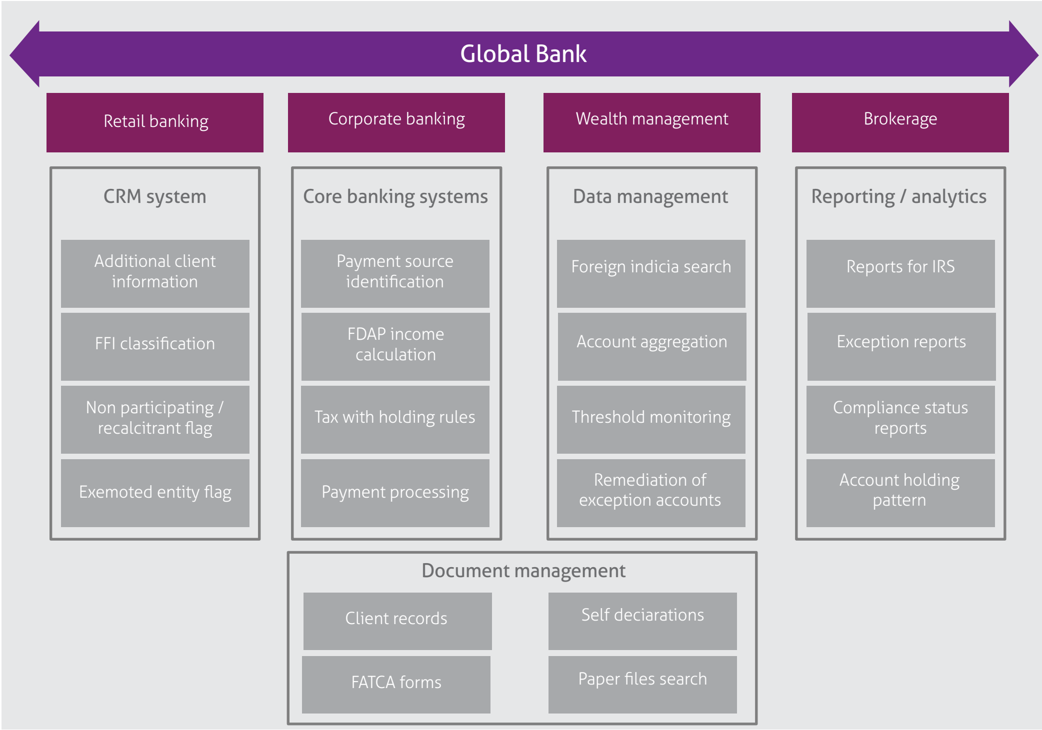
Integrating internal systems: Multiple systems within the institution's IT landscape will have to be linked efficiently to enable data collation and aggregation to generate the required reports. This may be a challenging task, depending on the scalability of the institution's IT architecture.

Enhancing existing systems: Impacted institutions will have to enhance their existing applications, or in some cases build new ones, to bring in a robust rules management engine that can identify entities to be reported. They will also have to bring in business intelligence to create regulatory reports and enable senior executives to monitor compliance.

Organizational impact

FATCA legislation has enterprise-wide impact on the processes and IT systems of a financial firm. The applications which will require significant modifications to comply with FATCA include:

- KYC / AML and client onboarding systems
- Customer information management system
- Document management systems
- Payments and transaction processing systems
- Regulatory reporting processes
- Accounting and taxation systems



Key steps for compliance

FFIs need to have a detailed understanding of FATCA and analyze its impact on the business. They must have a clear view of what their business will look like in the future and how they want to position themselves in the new environment.

Some important steps to move towards FATCA compliance:

Understanding FATCA: Workshops and consultations with specialists can help leaders gain an understanding of new regulations and their effect on business activities.

Strategic decisions: Financial intermediaries must decide whether US persons will be retained as clients and whether US securities will be included.

Implementation guidance: FATCA implementation and the actual specifics of the requirements must be continually analyzed and an operating model must be adapted to prepare for compliance. FFIs need to:

- Educate about the need to comply with FATCA
- Conduct a high-level review of affected business operations and entities
- Assign primary points of contact for the FATCA initiative and for affected operations and entities
- Develop an initial FATCA roadmap with timelines, work streams, outputs and targeted deadline
- Study how entities currently keep track of customer accounts and if the accounts are linked to one another
- Ascertain data that is kept on paper and stored electronically
- Identify processes, procedures and technology systems that will need to be enhanced or added

Implementation: Financial institutions will need time to make their processes and systems compliant to the new regulations. Systems should be ready three months prior to the application of new FATCA regulations, so as to ascertain smooth functioning.

Suggested roadmap for FATCA compliance

Analyze the regulation

- Create inventory of regulations
- Analyze FATCA requirements for On-boarding and identification, reporting and withholding
- Analysis of implementation guidelines.

Impact assessment

- Assess impact of the regulation
  - Identify impacted lines of businesses.
  - Identify accounts category
  - Identify impacted systems
  - Identify impacted processes
- Communicate impact across the organization
- Strategic decision making on compliance

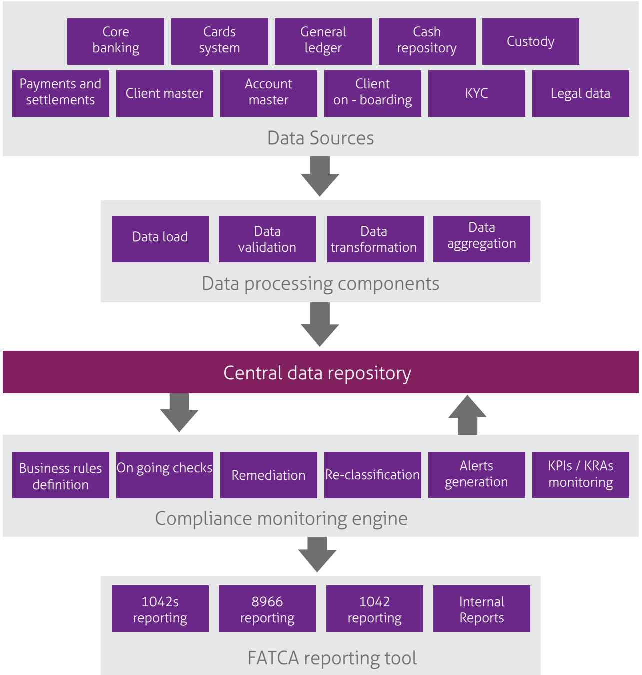
Future state planning

- Consolidate assessment
- Identify action plans to mitigate gaps.
- Define future operating model
- Prioritization of implementation blocks
- Initiate regulatory training within the organization
- Ensure IT is aligned with the regulatory objectives

Implementation

- Implement changes in policies and procedures
- Build / Enhance IT to ensure robust client screening and transaction reporting to the regulators.
- Proactively monitor communication from regulators on additions / amendments to the regulation.

Indicative IT end state for FATCA compliance



Mindtree's Capital Markets Center of excellence (CoE) has been at the forefront of tracking FATCA legislation developments. Based on our experience and subject knowledge, we can build custom solutions for financial institutions for effective FATCA compliance.

Account identification: Our solution enables financial enterprises identify accounts of US citizens based on US indicia, as required by FATCA. It applies various business rules to identify reportable accounts, taking into consideration accounts exempted from FATCA.

Aggregation: Our solution assists financial enterprises link accounts of an individual or entity across different business units. It facilitates aggregation by referring to data elements such as customer name, customer ID and tax identification number. It aggregates balance or value of accounts held by the person and determines if the value is above the threshold and if the accounts are reportable under FATCA.

Reporting: Our solution generates reports for each FATCA reportable account, as per the requirements of IRS or tax authority of the home country. The reports vary depending on whether it is a custodial account, depository account or account of an investment or insurance entity.

Analytics: The solution incorporates an ETL layer and an analytics framework. It enables financial services enterprises to effectively analyze account holding patterns and their FATCA compliance status.

Conclusion

FATCA is one of the most far-reaching tax legislation to impact financial institutions globally. FATCA compliance is complex and time consuming, and requires co-ordination of several business lines and geographies. In addition, timing is of utmost importance and deadlines are fast approaching. Its time FFIs began their due-diligence procedures to review individual accounts. The focus is on rapid deployment at reduced compliance costs. Allocating adequate resources to plan, choose and deploy a comprehensive FATCA solution will help reduce risks and costs significantly, and streamline deployment. FFIs should seek to develop robust technology platforms and reporting systems that not only cater to FATCA requirements, but that are also adaptable to any future regulations.

About the author

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Head Capital Markets CoE

Subhasis Bandyopadhyay, General Manager - Capital Market COE head in Mindtree brings about 20 years in global Capital Market and IT experience with strong customer management exposure in both buy side and sell side landscape of capital market domain. He is responsible for offering leadership and direction for capital market solutions, domain consulting, alliance management, domain competence building and pre-sales for Capital Markets in the BFSI IG. He is instrumental in setting up GRC (Governance Risk and Compliance) practice within Capital Market COE and built up solutions in Dodd Frank. EMIR, FATCA, Basel III, MiFid II and AIFMD and engaged in offering services as strategic and process consulting, solution development and roll out for leading customers in US, UK, Europe and APAC.

Subhasis earned a bachelor's degree in Physics from Calcutta University and a master's degree in business administration from University of Calcutta.

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About Mindtree

Mindtree [NSE: MINDTREE] delivers technology services and accelerates growth for Global 1000 companies by solving complex business challenges with breakthrough technical innovations. Mindtree specializes in e-commerce, mobility, cloud enablement, digital transformation, business intelligence, data analytics, testing, infrastructure, EAI and ERP solutions. We are among the fastest growing technology firms globally with more than 200 clients and offices in 14 countries.