Regulation Asia

FATCA & CRS

BEYOND REPORTING: DATA OVERLOAD

SPOTLIGHT ON INDIA

AXIOMSL™

Transparency through Technology

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1 | BACKGROUND

Global tax evasion and the opacity of tax havens has led to world-wide efforts to improve coordination and exchange of financial information among nations. The US initiated these efforts through FATCA (the Foreign Account Tax Compliance Act), which requires financial institutions around the world to collect data on the financial transactions and account balances of US citizens and report back to the IRS (Internal Revenue Service).

The technology and personnel cost of complying with the far-reaching law prompted some financial firms to avoid on-boarding new US accounts altogether. Despite the widespread furore and perceived complexity, the extent to which implementation has changed firms' compliance costs is overstated. Most firms, with limited exposure to US accounts, did not require a large amount of investment in technology upgrades or employee training.

This is set to change as the deadline for CRS (the Common Reporting Standard) looms ever closer. CRS, which closely followed FATCA, is a set of globally coordinated tax disclosure agreements, which will see signatory governments from the G20 and OECD collecting data from domestic financial institutions and exchanging under mutual disclosure. For the AEOI (Automatic Exchange of Information) framework under CRS, designed to provide actionable information to global tax authorities, ensuring high-quality data is key. It is therefore essential for multinational firms about to come under the CRS umbrella, to create a standardised data collection system reducing discrepancies and inconsistencies.

A Common Misconception

CRS builds on the Model 1 FATCA IGAs (Intergovernmental Agreements) despite its link to the FATCA framework, it is not a global FATCA or ‘GATCA’. This is because the scale of the new global framework is much broader in terms of the volume of data required for collection and dissemination.

According to KPMG research:

> FATCA is much narrower in scope than the CRS, and only focuses on certain US persons, so the programmes built for this Standard cannot simply be enhanced slightly to comply with AEOI. This becomes even more apparent when comparing the treatment of certain investment entities under the CRS with their treatment under the Model 1 IGAs […] It is thus highly unlikely that entity classifications under the CRS will mirror FATCA classifications in all instances.

Not only could entities have different responsibilities under the two regimes, but the status of customers or investors can also vary. The IT system would therefore need new fields to capture these classifications – and possibly a different process for the two regimes, if the status of the institution itself differs.

Although some firms were able to get by under the FATCA regime with minimal change to their systems, the reality of CRS is that financial institutions will require a major overhaul of the way they identify clients (since CRS, unlike FATCA, takes into account tax residency and not nationality/citizenship) and collect and report client data to their respective governments.

Patrick Yip, international tax partner for Deloitte, China, obseves that CRS’s focus on tax residency is a substantial compliance issue compared to FATCA. The concept of an individual’s tax residency still lacks clarity in most situations, and many different factors come into play when determining this. Not only will this require greater due diligence during client on-boarding, it will also impact review of pre-existing accounts.

The Reality

In fact, for firms that have legacy systems compliant with FATCA, there is a greater challenge in scaling systems up to include current and prospective CRS signatories.

According to KPMG:

> Financial institutions that took a tactical approach to their FATCA solution, either by creating temporary manual processes or by excluding US persons, cannot now simply upgrade their FATCA systems. Instead, they may have to invest in flexible information technology (IT) architecture that can adapt to evolving regulations, and to new countries coming on board. For institutions with legacy systems, the introduction of new, flexible IT architecture may result in the added complexity of aggregation policies.

According to an Asia-based compliance officer at a global investment bank, a lack of consistency in KYC (know your customer) norms across different signatory jurisdictions is a key source of complexity in developing systems to capture the data required. This makes it difficult to create a standardised collection system that applies to cross-border branches of an institution. This is because, as well as different AML and KYC norms among international jurisdictions, domestic tax laws also require data collection and reporting, adding to the complexity of regulations with which financial institutions must comply. So, although CRS can be narrowly defined as international information exchange and disclosure rules, domestic regulations such as the EU Savings Directive and the US FATCA are already in place.

This duplication of effort is an additional burden on financial institutions. However, many of the data points required to be reported under FATCA will also fall under CRS requirements, drawing heavily on the intergovernmental approach of the US law. Finally, as CRS is implemented at a local level, “there may be further differences in the way in which each jurisdiction interprets the Standard. So, for financial institutions operating in multiple jurisdictions, this would pose additional difficulties for internal risk and tax managers to keep track of all the local differences,” notes Deloitte’s Yip.

2 | REGULATORY TIMELINES

Some 101 countries have agreed to adopt the CRS. Fifty-five are early adopters who will begin exchanging information by 2017. The others will begin information exchange by 2018.

COUNTRY-LEVEL GOALS FOR THE COMMON REPORTING STANDARDS

Goal	Steps
1	Translating client on-boarding, due diligence and monitoring, and reporting rules into domestic law
2	Establishing a legal basis for agreements between countries for AEOI
3	Building administrative and IT infrastructure to collect and exchange tax information
4	Protecting confidentiality and safeguarding data

Source: OECD's CRS implementation handbook

TIMELINE FOR EARLY ADOPTERS

Date	Steps
January 2016	Record tax residence and entity status for new accounts
December 2016	Identify high-value pre-existing individual accounts (balance over USD1 million as of 31 December 2015)
December 2017	Identify low-value pre-existing individual accounts (balance under USD1 million as of 31 December 2015); review all pre-existing accounts

The exact dates for AEOI between two countries will depend on the agreement between them. For a list of early and late adopters, consult this OECD document.

3 | DEMYSTIFYING THE CHALLENGES

The primary challenges of CRS for financial institutions are mostly linked to the scale and amount of data they need to collect. They will have to perform due diligence for CRS on all clients during on-boarding, making it as important as AML and KYC regulations. Transitioning between different tax information exchange regimes is a further area of concern. Yip adds:

> “FATCA and CRS, for example, have coinciding implementation dates in 2017. This may cause some operational headache for firms that may not have planned ahead.
>
> Gathering the required information from clients is a significant part of compliance, and financial institutions will face difficulties in ensuring all data points are accurately covered during the on-boarding process. Follow-up data may be late in coming depending on client responsiveness and will be a challenge for client-facing divisions.”

Collecting, validating and storing the large volume of additional data required for CRS will require substantial resources and expenditure.

“Given the wide range of formats and models and the large amount of information, it will impose a significant cost on businesses. Further different domestic standards for tax transparency, along with heavy reliance on local AML/KYC requirements could conflict among each other which could limit efficiency and further increase costs,” Yip says.“Because the signatories are allowed to make changes to the standard based on domestic requirements, this will make standardisation and an automatic exchange system harder to create. It is important to have a standardised data collection and exchange system so information can be processed quickly and efficiently.”

Financial institutions also need to adopt procedures which detect changes to regulations and data requirements in jurisdictions where they report. According to a UK-based chartered accountant, they will need to continuously monitor existing customer accounts to detect any changes in reportable status. The same due diligence will be required for new clients.

Although more than 100 jurisdictions have already committed to collect and exchange data between 2017 and 2018, new countries are likely to join, making preparation for compliance an ongoing process for financial institutions. This will require greater attention to regulatory developments and add to operational and financial burdens for data collection and reporting. It also means educating clients on new tax regimes and data requirements will be a continuous process.

“Flexibility and scalability in IT and knowledge infrastructure will be necessary to ensure firm technology and employee expertise can be adjusted quickly as new requirements come up,” the chartered accountant says.

As banks have more than one on-boarding system, updating all of them multiple times as the global regulation evolves may prove to be costly. Yip at Deloitte suggests most banks would choose to take a “wider approach” to include as many countries as possible under CRS in their systems revamp. By taking as broad an approach as possible, banks can avoid having to make too many changes to their systems.

“Multiple systems revamp will be costly for sure. Banks will need to include as many countries as possible in their systems revamp design in one go, even though some of those included may not yet enter the CRS system as far as the bank’s jurisdiction is concerned,” he says.

Banks’ monitoring burden will also be much higher as the base of countries and clients will significantly expand under CRS. As different clients’ (statuses) change, this will pose an additional issue as to the extent to which every individual will be able - or willing - to share developments in their tax residency with banks.

“How often a bank can ask questions on changes on client status requires a balancing act between regulatory compliance and customer service. A general rule is the more information a bank employee has access to, the higher standard the employees will be held to. So for a private banking client, for example, it is inconceivable that the bank doesn’t have as much information as possible on changes to client status. In terms of monitoring information, certain sectors and certain business lines within a financial institution will have greater requirements compared to others,” says Yip.

A senior tax professional at a global asset management firm observes that financial institutions' effectiveness in complying with the requirements of tax transparency regimes will be an important driver of their reputation among clients and regulators.

"The ability to effectively collect and monitor data for reporting to tax authorities will be an important differentiator for clients that are more sensitive and demanding on issues regarding taxation," he says.

Advantage aside, non-compliance could have dire consequences for firms and their employees. Under some jurisdictions, such as Hong Kong, individual employees of financial institutions can be personally liable in instances of "intentional disregard of the law," according to Yip.

> "This is concerning as FATCA doesn't have this liability. The global Standard is not clear on whether individuals should be penalised, but local interpretations may be different. So, in Hong Kong for example, where personal liability for employees exists under the Standard, it may cause individuals to go overboard in compliance or simply turn clients away."

4 | DUE DILIGENCE

Financial institutions must identify reportable accounts under CRS for individual countries that sign bilateral AEOI agreements. The OECD norms outline due diligence requirements for new and pre-existing accounts. For the former, financial institutions must further distinguish between high-value individual accounts with aggregate balances of over USD1 million and those under that level. There is no minimum threshold for CRS accounts, unlike under FATCA, where accounts under USD50,000 can be excluded from review.

As previously highlighted, the Standard relies on AML and KYC norms as a baseline for due diligence during on-boarding. They also allow reasonable self-certification in accepting client accounts where information under AML/KYC procedures is not available. For pre-existing accounts smaller than USD250,000, an institution can skip review procedures under CRS only if domestic tax transparency rules allow.

There are additional rules for account holders deemed “passive non-financial entities” where controlling entities might need to submit a self-certification statement. According to a regulatory professional at an Asia-based law firm, the ultimate goal for due-diligence on pre-existing accounts is to identify “reportable accounts” which have a fairly broad definition under the Standards, leading to a substantial increase in the number of such accounts.

KEY FINANCIAL INFORMATION TO BE REPORTED UNDER CRS

1. Interest
2. Dividends
3. Account balance
4. Income from insurance products
5. Proceeds from the sale of financial assets

Source: KPMG

5 | SPOTLIGHT ON INDIA

Countering tax evasion and transparency is an important political aim for the governing party in India. Public anger around so-called “black money,” is commonplace, especially related to funds parked in the offshore accounts of wealthy Indians. This reached its peak during the 2014 general election cycle.

Unsurprisingly, India was among the first countries in Asia to sign up to the early adoption of CRS. It signed the IGA with the OECD in June 2015. That December, the CBDT (Central Board of Direct Taxation) put out guidance on the new reporting requirements under CRS. The government has been swift in amending the relevant legislation (the Finance Act of 2014 and the Income Tax Act) to ensure local tax authorities can exchange tax information automatically.

According to Vishal Motwani, associate director at PricewaterhouseCoopers in Mumbai, in the beginning — at least — India will probably see less information coming from other tax authorities than it is expected to share.

“India doesn’t have the bargaining power and you will see a lot of countries, say Switzerland, which has signed up to comply at a later date; they will be answerable to a smaller set of countries. So, at things stand, we will be providing more information than we will receive in the next few years,” he says.

For most financial institutions, information requirements will be similar to the global Standard. TP Janani, senior member for international tax practice at law firm Nishith Desai, notes Indian authorities are focused on ensuring administrative ease for compliance under FATCA and CRS and are looking to avoid major differences in inter-governmental agreements that it is signing and will sign under the global standard.

“For India, the main idea is to make information collection administratively convenient. For this reason, since most incoming business in India is from the US, the main classifications that firms need to adopt are for US clients and non-US clients. The latter are all clubbed into one bucket. So this makes it easier to comply,” she says.

According to a senior compliance executive at a domestic fund manager, key areas of work to build up to CRS have involved employee training and ensuring IT enhancement to provide a single view of customer information.

This is further complicated by the fact the CRS and its implications and timelines remain largely unknown to the larger client base, he says, and responsibilities on customer education have fallen largely on complying institutions.

“The government needs to make taxpayer education a priority, especially since most taxpayers need to provide self-certification on their tax and residency status. This will also help customers respond faster to information requests,” he says.

PwC’s Motwani echoes global concerns around the volume of information and scope of coverage being much larger under CRS than under FATCA. However, he says that for institutions which have complied with FATCA, even through manual processes, the assessment phase for CRS will be much shorter.

“The upside for FATCA compliance is that banks have already thought about what the impact areas within their infrastructure will be, and these will broadly remain the same under the CRS. This will help them in their CRS journey. There might be further tax implications, but from a technology perspective, they would know where the rules need to change and scale up from there,” he says.

Industry participants are also attempting to build a central data repository for client information — not only at a firm level but also industry-wide — to ensure basic information during KYC and on-boarding is available to multiple institutions with which a client may be doing business This will also prevent clients from having to repeatedly self-report the same information.

Motwani says firm-level data repositories will be important for a financial institution to have a single view of its interactions with clients across different product offerings. In the absence of such a repository, the firm will struggle in its compliance efforts.

“Not just for FATCA or CRS, there are host of other regulations that a bank can prepare itself for by creating the data repository,” he says.

Creating a data repository is important for a firm’s monitoring efforts. Motwani says monitoring will depend on whether a bank has the capability to have a single view of all transactions in one place. Firms will need a rule-based engine to sit on top of their reference data.

> “The job of this rule-based engine, or plug-in, would be to monitor any changes to the database. So rather than relying on your staff to detect change manually, it makes more sense for the firm to have a rules-based solution, which will automatically detect if a change made is a reportable event and allow the appropriate process to kick-in for reporting.”

Predictably, readiness levels throughout the industry are varied. According to the fund management compliance executive, most smaller firms continue to rely on manual processes.

“As increased regulation requires greater reporting and transparency on client data, it will become increasingly important that financial institutions create automation in the way they collate and monitor client data,” he says.

Motwani further says some large banks already have robust central data repositories. So, their compliance efforts will be mitigated and the data generated will be of better quality: “Their cost of compliance will be much lower, so there is a direct financial impact on how a firm is able to comply. More often than not, however, we are seeing our clients struggle.”

6 | CONCLUSIONS

Banks are tasked with managing vast amounts of customer data, underpinned by frequent changes, different reporting requirements and outdated data insufficient for meeting reporting standards. Banks should be employing an operating model that conducts daily CIC and validation checks, in addition to their self-certification process, that is able to effectively and efficiently identify changes or inconsistencies. As regulations change, an enterprise-wide solution for change management should be front of mind as regulatory costs threaten to overwhelm.

AxiomSL's 'one platform' approach presents an integrated solution with the ability to aggregate data across multiple repositories and jurisdictions as well as offering enrichment and validation. This streamlines internal controls and processes, reducing reporting costs and complexities substantially as clients no longer need to maintain separate systems to comply with differing reporting requirements.

Configurable business dashboards allow users to monitor the entire reporting process, making it possible to manage the attestation of the large number of reports associated with CRS. The unparalleled transparency includes the ability to drill down from the final reports to the source data, allowing users to make manual adjustments.

AxiomSL supplies and maintains all reporting schemas and validation rules required for both standard and FATCA and CRS reporting. This extends to India, where RBI has stipulated over 70 additional attributes. When these change, updated templates are automatically provided, relieving users of burdensome maintenance work.

The scalable, highly-flexible platform empowers financial institutions to become FATCA and CRS compliant, with a full audit trail ensuring traceability, automation and auditability. This helps avoid additional operational and financial costs whilst maintaining a strong competitive advantage.

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Additional contribution from market participants.

Regulation Asia

Regulation Asia tracks global regulatory developments impacting banking and capital markets across Asia-Pacific. Insight, research and events reach senior compliance, risk and regulatory professionals working across financial services.

AXIOMSL™

Transparency through Technology

AxiomSL is the leading global provider of regulatory reporting and risk management solutions for financial services firms, including banks, broker dealers, asset managers and insurance companies. Its unique enterprise data management (EDM) platform delivers data lineage, risk aggregation, analytics, workflow automation, validation and audit functionality.

The AxiomSL platform seamlessly integrates clients' source data from disparate systems and geographical locations without forcing data conversion. It enriches and validates the data, and runs it through risk and regulatory calculations to produce both internal and external reports. The platform supports disclosures in multiple formats, including XBRL. The unparalleled transparency offered by the high-performance platform gives users the ability to drill down on their data to any level of granularity.

AxiomSL's platform supports compliance with a wide range of global and local regulations, including Basel III capital and liquidity requirements, the Dodd-Frank Act, FATCA, AEI (CRS), EMIR, COREP/FINREP, CCAR, FDSF, BCBS 239, Solvency II, AIFMD, IFRS, central bank disclosures, and both market and credit risk management requirements. The enterprise-wide approach offered by AxiomSL enables clients to leverage their existing data and risk management infrastructure, and reduces implementation costs, time to market and complexity.

AxiomSL was awarded The Asian Banker's 2016 "Best Compliance Risk Technology Implementation of the Year" as well as "Best Implementation at a Sell-side Firm" in the 2016 Sell-side Technology Awards. It was voted Best Reporting System Provider in the 2015 Waters Rankings and was highlighted as a 'Category Leader' by Chartis Research in its 2015 Sell-side Risk Management Technology report. The company's work has also been recognized through a number of other accolades, including success in the Best Reporting Initiative category of the American Financial Technology Awards and in the Customer Satisfaction section of the Chartis RiskTech100 rankings.

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