AS FATCA DEADLINES LOOM, WHAT MANAGERS NEED TO KNOW

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SURVEY FINDINGS: Managers Are Not Fully Prepared

By now, virtually all investment managers are aware of the Foreign Account Tax Compliance Act (FATCA), which is designed to prevent tax evasion by U.S. taxpayers utilising unreported foreign financial accounts. The act requires foreign financial institutions (FFIs) to report U.S. account holders and U.S. persons to report the financial accounts they hold outside the U.S., with all of the information ultimately going to the Internal Revenue Service. It was enacted in March 2010, as part of the Hiring Incentives to Restore Employment Act (HIRE).

Given the complexity of these requirements, “getting ready for FATCA” has been the topic of extensive industry discussion. A recent survey conducted by SEI and DMS Offshore Investment Services Ltd. takes a closer look at managers’ challenges around FATCA compliance and next steps for plans and preparations for fund managers.

The survey, a sampling of investment managers across global markets and size categories, reveals serious gaps in FATCA awareness and preparation.

Many business partners and managers have not yet begun FATCA discussions

About the survey: It was conducted online in December 2013 by SEI in partnership with DMS Offshore Investment Services Ltd. Respondents included 58 C-level executives of investment advisors/managers, approximately 70% of which were based in North America. The sample was evenly divided among three size categories based on assets under management (AUM): less than $250 million, $250 million to $1 billion, and $1 billion or more.
More than 48% of respondents said they did not know the deadline by which FFIs are required to have a **Global Intermediary Identification Number (GIIN)**. An FFI is defined as a “financial institution” organised outside the U.S., such as a bank, investment fund, broker-dealer or custody bank.

**Managers are underestimating the costs of FATCA compliance**

When asked how much they expect to spend on key cost elements, a majority of the managers we surveyed expect their costs to be less than $10,000 per key provider per year. Specifically:

- **63%** estimated legal documentation and advice to cost less than $10,000
- **69%** estimated an administrator’s FATCA due diligence to cost less than $10,000
- **71%** estimated the FATCA Responsible Officer to cost less than $10,000
- **83%** estimated FATCA consulting to cost less than $10,000

With regard to who is expected to pay for those costs, respondents gave varied answers (see figure B), though the majority of them estimated that the fund would pay a larger portion of the expense.
WHO IS EXPECTED TO PAY?
Most of the managers expect the fund to pay a large portion of the expenses.

Managers are behind the curve on FATCA-related preparations, which include:

*Executing service agreement with reporting FFI’s administrator* — Only 14% said they have taken this step; 60% are in the process and 26% are either unprepared or don’t know.

*Planning for completion of investor due diligence* — While 26% expect completion in advance of FATCA timelines and 41% expect to accomplish the task “in time,” one-third of those we sampled have either not yet established a plan or have yet to decide how to proceed.

*Determining which due diligence documents to use* — Among those we surveyed, 41% had not yet decided whether to rely on existing due diligence documents or obtain new W-8 and W-9 forms from all investors in the reporting FFIs.

*The upshot of our survey findings: It appears that many managers are still in the process of dealing with FATCA’s requirements and implications — and time is running out.*
Managers can use the following timeline to help better prepare for FATCA.

**FATCA Timeline (2014 to 2017)**

**2014**
- **1 January to 5 May 2014**: FFI Electronic Applications period starts.
- **30 June 2014**: FFI Agreements are effective.
- **1 July 2014**: FATCA withholding on FDAP payments to nonparticipating FFIs and recalcitrant account holders begins with respect to new accounts.
- **1 July 2014**: Existing obligations are grandfathered.
- **1 July 2014**: Account opening procedures implemented to identify U.S. accounts.

**2015**
- **1 January 2015**: FATCA withholding begins on preexisting obligations of nondocumented prima facie FFIs.
- **March 15, 2015**: Forms 1042 are due for first FATCA withholding on FDAP income, then annually.
- **March 31, 2015**: Participating FFIs first report due with respect to U.S. accounts for 2014 calendar year, then annually each 31 March.
- **15 March 2015**: Completing first report due for FIs for 2014 calendar year, then annually each 31 March.

**2016**
- **30 June 2016**: Complete due diligence for other preexisting entity accounts and non-high value individual accounts.
- **1 September 2016**: Due date for initial certification of all due diligence.

**2017**
- **1 January 2017**: FATCA withholding on gross proceeds from the sale of U.S. assets begins; withholding on passthru payments may begin on or after this date.
- **15 March 2017**: Aggregate reporting due for passthru payments of FDAP to nonparticipating FFIs for 2016.
- **1 July 2016**: Withholding begins on FDAP payments on preexisting obligations of nondocumented entities other than prima facie FFIs and individual non-high-value accounts.
- **March 15, 2016**: Aggregate reporting due for passthru payments of FDAP to nonparticipating FFIs for 2015.
- **30 June 2016**: Complete due diligence for preexisting high value individual accounts.

**What is the impact of the deadline?**

Once registered, FFIs must certify in 2015 that they were compliant with FATCA obligations as of 1 July 2014. In order to ensure that they are registered on the first GIIN list, which comes out on 2 June 2014, FFIs must register by 5 May 2014.
**Timeline Events**

1. **January 1 to April 25, 2014**
   - FFI Electronic Applications period starts.

2. **June 30, 2014**
   - FFI Agreements are effective.

3. **July 1, 2014**
   - Account opening procedures implemented to identify U.S. accounts.
   - Existing obligations are grandfathered.

4. **July 1, 2015**
   - Withholding begins on FDAP payments on preexisting individual high-value accounts.

5. **January 1, 2015**
   - FATCA withholding begins on preexisting obligations of nondocumented prima facie FFIs.

6. **March 15, 2015**
   - Forms 1042 are due for first FATCA withholding on FDAP income, then annually.

7. **March 31, 2015**
   - Participating FFIs first report due with respect to U.S. accounts for 2014 calendar year, then annually each March 31.

8. **December 31, 2014**
   - Complete due diligence for preexisting accounts of prima facie FFIs.

   - 30 June 2015
     - Complete due diligence for preexisting high value individual accounts.

10. **January 1, 2017**
    - FATCA withholding on gross proceeds from the sale of U.S. assets begins; withholding on passthru payments may begin on or after this date.

11. **March 15, 2017**
    - Aggregate reporting due for passthru payments of FDAP to nonparticipating FFIs for 2016.

12. **July 1, 2016**
    - Withholding begins on FDAP payments on preexisting obligations of nondocumented entities other than prima facie FFIs and individual non-high-value accounts.

13. **March 15, 2016**
    - Aggregate reporting due for passthru payments of FDAP to nonparticipating FFIs for 2015.

14. **June 30, 2016**
    - Complete due diligence for other preexisting entity accounts and non-high value individual accounts.

15. **September 1, 2016**
    - Due date for initial certification of all due diligence.

16. **2016**
    - **15 March 2016**
      - Aggregate reporting due for passthru payments of FDAP to nonparticipating FFIs for 2015.

17. **2017**
    - **15 March 2017**
      - Aggregate reporting due for passthru payments of FDAP to nonparticipating FFIs for 2016.

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**Timeline Events**

- FFI Agreement
- Due Diligence Procedures
- Withholding
- Reporting
An interview with June Oakes, Director of Regulatory and Compliance Solutions for SEI’s Investment Manager Services division

**What do managers need to focus on with regard to FATCA?**

FATCA has introduced a unique regulatory regime. In addition to dealing with its short-term requirements, managers also need to consider the longer-term implications. The *Intergovernmental Agreements (IGAs)* that govern how other countries report investor information to the U.S. Internal Revenue Service are still being finalised. Moreover, many of these agreements will be reciprocal, meaning that the U.S. will be required to report information about residents of foreign countries back to those nations.

Beyond that, compiling and reporting investor information involves a variety of complexities. Not all of them will affect all managers, but every manager needs to be aware of the requirements and what they entail.

**What concerns you the most about FATCA compliance?**

As someone who is assisting managers with FATCA compliance by providing outsourced operating solutions, I worry that managers may be underestimating the effort and time it will take to prepare for compliance with the regulations. Mark Powell, the tax director for SEI’s Investment Manager Services division, and I have been meeting with clients to discuss due diligence procedures for documenting accounts, and we’ve often been asked, in essence, “Aren’t you going to handle that for us?” The reality is that the FRO is ultimately responsible for FATCA compliance, and that person must proactively reach out to service providers to understand their capabilities around FATCA and how it fits into their requirements.

Nearly seven in 10 survey respondents pegged the annual cost of their administrators’ FATCA due diligence as less than $10,000 per entity. How does that finding strike you?

For many managers, a more realistic estimate would be greater than that amount, depending, of course, on the size of the manager and the number of its funds and investors. The complexity and scale of the task is such that managers should really expect to amend their existing fund administration contracts in order to benefit from additional systems and resources to support FACTA compliance.

“I worry that managers are greatly underestimating the complexity of the regulation...my message is, ‘don’t wait any longer to get a handle on this.’ ”
What are the most important things managers need to be doing about FATCA, and what pitfalls should they watch out for along the way?

First, fund managers will need to determine which entities they must register as FFIs. Funds that are offshore will generally need to register with the IRS. Managers should also monitor the status of the pending intergovernmental agreements, if their service provider isn’t already doing that on their behalf.

Second, if the manager is a FFI, the manager will also need to appoint a FRO who will certify compliance to the U.S. Treasury on a regular basis. Tempting as it may be to simply assign the job to a compliance staff member, the assignment should be made with care. The FRO role requires specialised expertise; it also carries substantial liability and penalties if a fund turns out to be noncompliant. Given the risk, most fund administrators will not take on the “responsible officer” role, although a boutique compliance company may be willing to do that. Some managers might conclude that designating their Chief Compliance Officer (CCO) as the responsible officer is the logical solution, but that, too, could have a downside, such as changes in board independence. It is also important that the CCO assumes the same fiduciary duties for the affairs of the FFI as all directors do. As a result, many institutions chose to appoint a FRO as an officer to the FFI.

Third, I’d recommend that managers take a hard look at the expertise they have available to understand, interpret and implement FATCA procedures. Some firms do have that expertise in-house; many don’t. Either way, firms may want to leverage the expertise of a dedicated compliance unit at a service provider.

Finally, with regard to dealing with investors, managers should review their subscription documents and make sure they have the appropriate legal language to request the necessary documentation. They may want to get some legal help if it is necessary to update the language.

What about choosing a service provider to help with FATCA implementation? How should managers go about that?

The most likely candidate is the provider who already does a manager’s investor servicing — that provider is the closest to the investors and already has processes for handling due diligence documentation. For traditional funds, that would be the transfer agent. For alternative funds, that would be a fund administrator such as SEI.

Do you have any final thoughts or messages on this subject?

Because the regulation imposes a withholding tax on institutions that fail to provide the information required, FATCA has become an important and urgent element of managers’ businesses. If I could get just one message across, it would be, “Don’t wait any longer to get a handle on this.” There are many resources available, and those resources should be identified as soon as possible to ensure a cost-efficient and complete process.
ABOUT SEI

SEI (NASDAQ :SEIC) is a leading global provider of investment processing, fund processing, and investment management business outsourcing solutions that help corporations, financial institutions, financial advisors, and ultra-high-net-worth families create and manage wealth. As of 31 December 2013, through its subsidiaries and partnerships in which the company has a significant interest, SEI manages or administers $559 billion in mutual fund and pooled or separately managed assets, including $232 billion in assets under management and $327 billion in client assets under administration.

SEI's Investment Manager Services division provides comprehensive operational outsourcing solutions to support investment managers globally across a range of registered and unregistered fund structures, diverse investment strategies and jurisdictions. With expertise covering traditional and alternative investment vehicles, the division applies customised operating services, industry leading technologies, and practical business and regulatory insights to each client's business objectives. SEI's resources enable clients to meet the demands of the marketplace and sharpen business strategies by focusing on their core competencies. The division has been recently recognised by Buy-Side Technology as “Best Outsourcing Provider to the Buy Side” and “Best Fund Administrator,” by Global Custodian as a “Top Rated Hedge Fund Administrator,” and by HFMWeek as “Most Innovative Fund Administrator (Over $30B AUA)” for hedge funds both in the U.S. and in Europe.

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