Using IBM Banking Process and Service Models to Support FATCA

Compliance Challenges

Financial institutions are facing a series of compliance challenges. In response to these challenges, a number of regulatory initia¬tives have sought to mitigate these risks. These initiatives include Basel II/III, IFRS/IAS, MISMO, Sarbanes-Oxley Act, Dodd-Frank, and now FATCA.

In order to help financial institutions meet the ever increasing compliance challenges, IBM® Banking Process and Services Models provide the combination of expertise in mod¬eling techniques with deep industry knowledge and experience gained over a number of years. A key advantage of IBM Bank¬ing Process and Service Models is that it provides a business focus on what is required for a business topic, and allows the underlying implementation to follow.

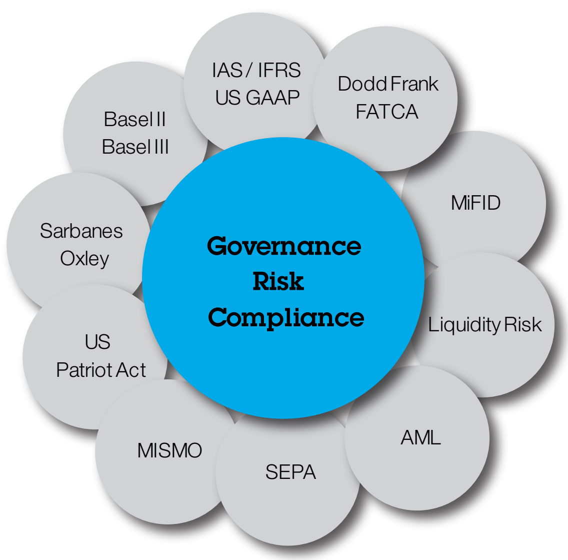

Figure 1. Compliance challenges facing financial institutions

Financial institutions are faced with numerous compliance requirements. It is imperative that there is as much reuse as pos¬sible in the underlying I.T. Infrastructure. This is especially the case in terms of data consolidation and reporting requirements

As the worldwide financial regulatory approach switches from "light touch" supervision to tougher rule enforcement, there is a growing burden on financial institutions to provide more information to regulatory agencies, with clear demonstration of compliance. So in addition to the procedural and governance changes that are prescribed, there is an emphasis on demonstrating this compliance.

Understanding FATCA

The Hiring Incentives for Restoring Employment Act (H.R. 2847) ("HIRE") act was signed on 10 March 2010. This Act included the Foreign Accounts Tax Compliance Act (FATCA), which became effective in 2013 and is intended to increase transparency for the US Internal Revenue Service (IRS) concerning US persons that might be investing and earning income through non-U.S. institutions.

FATCA:

- Adds a new Chapter 4 to the US IRS code including four new sections (1471-1474)
- Targets non-compliance by US taxpayers using foreign accounts. Under FATCA, US taxpayers with specified foreign financial assets that exceed certain thresholds must report those assets to the IRS.

- Requires foreign financial institutions (FFIs) to report to the IRS information about financial accounts that are held by US taxpayers, or by foreign entities in which US taxpayers hold a substantial ownership interest.
- Requires participating FFIs to withhold 30% of all U.S.-sourced payments to recalcitrant customers
- Penalizes FFIs who are non-compliant by applying a 30% withholding tax

FATCA is a complex regulation that has widespread consequences for financial institutions around the globe. The Act introduces new procedural requirements that might prove costly to participating financial institutions, and even more costly for non-participating ones, in the form of penalties and withholding tax on US sourced income

The Foreign Account Tax Compliance Act (FATCA) is an important development in US efforts to improve tax compliance involving foreign financial assets and offshore accounts.

Under FATCA, US taxpayers with specified foreign financial assets that exceed certain thresholds must report those assets to the Internal Revenue Service (IRS). This reporting is made on Form 8938, which taxpayers attach to their federal income tax return, starting this tax filing season.

In addition, FATCA requires foreign financial institutions to report directly to the IRS information about financial accounts that are held by US taxpayers, or held by foreign entities in which US taxpayers hold a substantial ownership interest. The purpose of the Act is to:

- Reduce the loss of tax income to the US IRS by identifying tax non-compliance by US taxpayers with foreign accounts
- Improve understanding of tax compliance by US persons by receiving account information on US persons from non-US financial institutions worldwide.

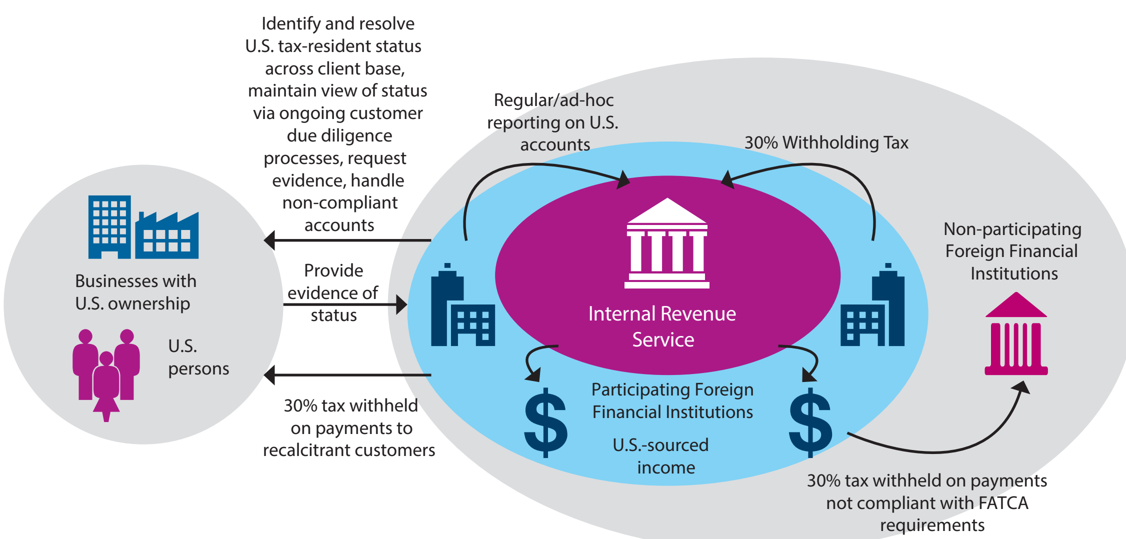

Figure 2. FATCA context[1]

Addressing the Challenges

IBM Banking Process and Service Models help financial institutions achieve their strategic objectives by the adopting and using the best practices and open standards that are advocated by the IBM vision of a service-oriented architecture. This allows financial institutions to focus on business process improvements through the use of IBM Banking Process and Service Model components, which fast track the development of 'to-be' business scenarios.

Business process re-engineering also facilitates the better alignment of business to I.T. and the optimization of straight through processing solutions, where appropriate, with resultant efficiencies and cost reductions. This is achieved through the definition of services that are independent of line of business and product and can be reused across the enterprise.

IBM Banking Process and Service Models support help fast tracking institutions in their FATCA transformation strategies by offering organizations the means to reengineer their solutions and put business drivers at the heart of their strategic objectives.

Why Serivce-oriented architecture?

A service-oriented architecture (SOA) provides customers with the technology required to enable business on demand. It facilitates the end-to-end integration of a financial services organization with its customers, partners, and suppliers that enables rapid response to customer demands, market opportunities, regulatory requirements, and external threats.

Business benefits of SOA

- Business flexibility is provided by increased granularity of processes that are enabled through services
- Business processes and composite applications can be quickly created, to respond to changes in the marketplace
- Improved customer service can be achieved by using services, without having to worry about the underlying I.T. infrastructure

I.T. benefits of SOA

- Creates a more responsive I.T. organization with a secure and managed integration environment
- Decrease development, deployment, and maintenance cycle times and costs by using pre-built, reusable services

IBM Banking Process and Service Model Components

IBM Banking Process and Service Models are a content-rich set of models that are designed specifically for financial services organizations, enhanced and extended to align with the requirements for risk and compliance and optimally allow for the development of more efficient straight through processing solutions.

By using IBM Banking Process and Service Models, the approach to transformation can be dramatically shortened, with consequent savings in time and money for the organization, the models represent leading practice and have been validated through use with many of the world's leading financial services organizations over several years. Through access to process and service models, customers report savings of approximately 40% in the analysis and design stages of any business process reengineering project. Customers also relate a 58% level of reuse of IBM Banking Process and Service Model collateral when undertaking their process improvements.[2]

IBM Banking Process and Service Models play a critical role in the definition of service-based architecture. It is only through analysis of the processes that support the operations of a financial institution that the service candidates that best support those processes can be identified. Process analysis also provides essential information about the context of those services, capturing requirements governing the applications that call services within the architecture, and the human roles within the organization that interact with those applications.

The Process Analysis Model has in excess of 400 business processes that can support and fast track organizations in their process re-engineering. It also identifies candidate business services that support the business processes. These reusable elements are analyzed further within the Service Analysis Model as service capabilities.

The service capability definitions isolate the proposed service definitions and allow the capturing of more requirements such as the type definitions that support the inputs and outputs of the service, the interactions between services and the delegation patterns that ultimately support the business of the financial institution.

The requirements that are captured within the Service Analysis Model can be used to construct a detailed design model of the actual services that are required to support the project. These service definitions are defined within the Service Design Model. These are component-based models that catalog services, and the interaction between services in the form of collaborations.

Process Analysis Model

The Process Analysis Model provides the business specification of the processes, which is used to underpin the initial analysis activities, and downstream design activities in determining the optimum subset of processes for a project from a business perspective.

- Specifies long running business processes that can be customized to an organization's needs in the context of specific initiatives
- Defines specific roles that are assigned to perform the tasks in the processes
- Provides template process models, which fast track the requirements gathering phase
- Accelerates solution development, reducing development time and cost
- Eliminates redundancy in process variation by maximizing the level of activity and trigger reuse
- Provides process data flow and role player best practice solution
- Provides an enforcement model for naming standards across all projects within the financial institution. This ensures that the level of reuse is maximized
- Contains traceability with Service Analysis Model rypes that it supports
- Identifies candidate service tasks (automatable tasks) and processes linked to from associated Service Analysis Model capability operations

Process Design Model

Provides the design level technical specification of the processes, which forms the basis for any downstream implementation of executable processes.

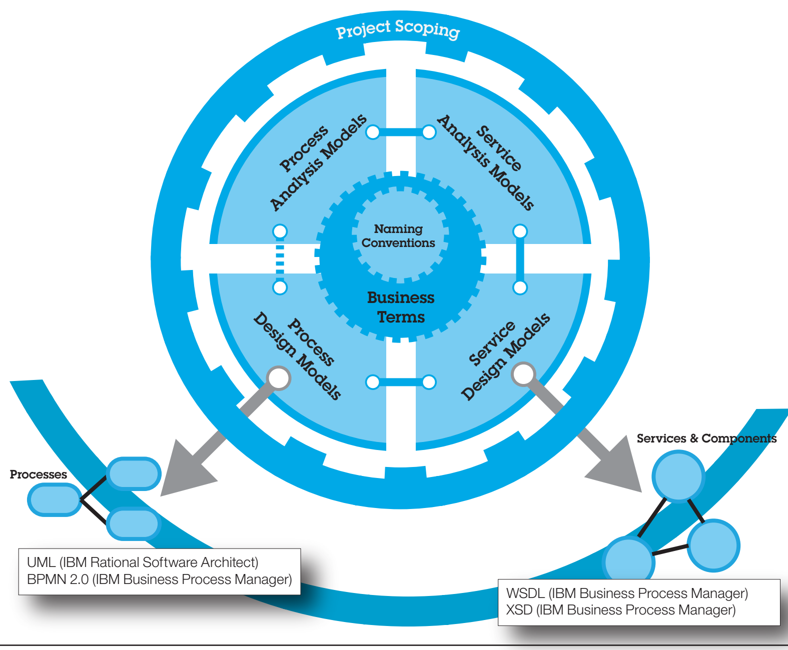

Figure 3. IBM Banking Process and Service Model components

- Design level business processes - intended for execution
- Contains equivalent business processes to the Process Anlysis Model, but in which candidate servicetasks are replaced with service tasks, which invoke services
- Data must pass consistently through design level business processes. Data in design level business processes must also be consistent with data in service messages
- Design level business processes can orchestrate complex invocations of services
- The structure of data artefacts is defined by Service Design Model primitive types, enumerations, and transfer objects

Service Analysis Model

The Service Analysis Model, provides business content and guidance for SOA analysts, designers, and systems developers. It is used to clearly capture any business requirements at a detailed level. Analysis of reusable elements within business processes that are defined by the IBM Banking Process Models allow the identification of candidate business services that support these processes. For example, the business process for Account Opening requires the retrieval of "customer details". Other business processes, elsewhere in the financial institution, have the same requirement. It is possible to identify a single solution that satisfies both these requirements and can be reused across the financial institution. This solution is a business service. The Service Analysis Model allows reusable elements within business processes to be explored further with the aim of identifying actual business services.

The Service Analysis Model provides technology independent class models that enable traceability between automated business process requirements and downstream SOA I.T. analysis representation. It:

- Is a highly normalized conceptual model that specifies the data structures that are required to represent the concepts that are defined in the Business Terms
- Is technology independent (does not contain any design/technical artifacts)
- Provides traceability with Business Terms that it supports
- Gives an enterprise-wide, generic, and flexible data representation for design of operational systems
- Serves as an overall reference point for business and I.T.
- Provides a powerful and precise means of communication and helps to bridge the innate gap between business and I.T. perspectives

Service Design Model

The Service Design Model takes the analysis-level candidate services and concepts that are identified within service analysis model and allows the financial institution to specify an SOA that meets these requirements. This task is normally performed by a technical team within the financial institution, who makes design-level decisions that are based on aspects such as the technology environment. This team works from a stable service analysis model that eliminates the need for repeated requirements specification. This greatly increases the applicability of technical solutions and reduces the time to specify them.

Class design

The Service Design Model provides a design for the development of components, types, interfaces, and data transfer objects for an enterprise-wide business services-based architecture. It:

- Contains reusable components, which define industry components at design level that is based on years of experience on customer projects

- Refines the Service Analysis Model class model and uses interfaces to expose structural component services and independent type behavior
- Is a Platform Independent Model (PIM) and is not dependent on a specific implementation technology
- Extends the applicability of the analysis assets to the design phase of projects, thus promoting the construction of IBM Industry Models based software.
- Defines a set of highly reusable components for the financial services industry by applying the principles of component-based development.

Services design

The Service Design Model provides a design for the development of participants, service interfaces, and messages appropriate for an enterprise-wide business services-based architecture. It:

- Contains the definition of transactional components (participants) and the services they provide, based on the capability operations that are identified in the Service Analysis Model
- Uses SoaML for definition of participants, services, service interfaces, and message types
- Defines and diagrammatically illustrates how transactional and structural services collaborate to support a specific business need
- Contains definitions of a standard set of services promotes the development of inter-operable financial services industry software
- Provides use of SoaML, enabling standardized service definitions and model portability

IBM Banking Process and Service Model Support for FATCA

IBM Banking Process and Service Model contains a rich set of processes for use in business transformation that is related to regulatory requirements, and has been extended to support FATCA in the following areas:

FATCA Foreign Financial Institution Participation

Financial institutions are required to register for participation in FATCA, are listed in an online database of participating FFIs, and must actively maintain compliance though regular reporting and application of relevant withholding penalties. For example the Process Analysis Model supports:

- Registration with the IRS
- Application to become a Participating FFI
- Application to be included in the online listing
- Compliance certification

FATCA Customer Onboarding and Know Your Customer (KYC)

There is a need for foreign financial institutions to understand their customer base, which is in scope for FATCA, as FFIs are required to perform due-diligence on their existing customers and to implement customer onboarding procedures for identifying new customers who are relevant to FATCA. For example the Process Analysis Model supports:

- Supports the profiling of individual customers
- Includes customer details review, and monitoring for FATCA consideration
- Specifies the request and collection of relevant documentation from identified customers

FATCA US Taxpayer Compliant

Under FATCA, US taxpayers with specified foreign financial assets that exceed certain thresholds must report those assets to the IRS. FFIs are required to gain and maintain self-certification from identified customers to ensure that those customers are compliant with FATCA. Otherwise, the FFI is required to apply a withholding tax on payments to that customer.

For example the Process Analysis Model specifies the documentation collection activities that need to be performed by an FFI for identified US taxpayers.

FATCA Withholding

The objective of FATCA is the reporting of foreign financial assets; withholding is the cost of not reporting. If a payment is deemed to require the application of a FATCA-related withholding tax, the FFI must apply that tax. For example the Process Analysis Model supports how to detail the determination of withholding requirement and application of any required withholding tax by Foreign Financial Institutions.

FATCA Reporting

FATCA focuses on reporting. FFIs are required to report annually, and on an ad hoc basis when requested, about financial accounts that are held by US taxpayers or foreign entities in which US taxpayers hold a substantial ownership interest. For example the Process Analysis Model supports:

- Determination of Reporting Requirements for the FFI
- Administration of Reporting to IRS or relevant reporting authority

Use Case

A financial institution intending to participate in FATCA, enters a long and complex undertaking, which will require a staggered implementation that is based on current and future regulation definition.

Addressing the challenges of FATCA requires the FFI to:

- Understand FATCA Regulatory Requirements
- Assess FATCA Impact on the Business
- Create and Maintain a FATCA Regulatory Policy
- Administer FATCA Registration
- Administer Customer On-boarding Updates
- Adopt FATCA Reporting Requirements
- Withhold Tax on Identified Payments

Process analysis and design

Understanding FATCA Regulatory Requirements
Although time is short, institutions should not rush into implementing FATCA. Instead, initially, a detailed understanding of the new Act should be obtained and the effects on the operating model should be thoroughly analyzed.

- Understanding FATCA to gain an understanding of the new regulations and their effect on business activities.
- Continuously analyzing the latest implementation guidance for FATCA and the actual specifics of the requirements to adapt the operating model so that organizations can prepare adequately for compliance.

Assessing FATCA Regulatory Impact
The first step in achieving FATCA compliance is to assess the current state of the organization and determine what current processes and technology can be used and that must be modified in order to be compliant. Among other activities, this step requires insurance companies to carry out the following activities:

- Entity analysis: Review the company's existing organizational structure and entity data to identify potential US FIs, FFIs, and NFFEs.
- Product analysis: Identify and review the company's product portfolio that might be subject to FATCA.
- Business Unit analysis: Review the documentation collection and management process for on-boarding, tax withholding, and KYC to see where indicial of US ownership or entity compliance can be found. Each business unit needs to also be assigned to the appropriate legal entities.
- Customer account analysis: Establish the number of US and non-US accounts/policyholders by legal entity. Identify the information that is collected from policy holders and gaps to remediate Review all existing customers by certain date Gathering / Recording US Beneficiaries.
- Review all policies to determine whether any policies are in scope.

Maintaining FATCA Regulatory Policy
The next step is to develop a target operating model—a view of the future state of the organization under FATCA—and create a preliminary implementation roadmap. Key activities during this step include:

- Defining target state regulatory, business, and functional requirements
- Defining future state operating models and technical architectures. Modify on-boarding procedures for new customers, but also new policies with existing customers.
- Conducting a gap analysis (current versus wanted future state)
- Creating a plan to remediate existing accounts and develop new "business as usual" processes
- Prioritizing roadmap and implementation plan by business unit
- Developing a business case and funding request

The corporate FATCA regulatory policy must address the following requirements:

- Determine the registration and participation in FATCA:
  - Is the foreign legal entity an FFI or NFFE?
  - Does an FFI intend to be a PFFI or non PFFI?
  - Does the foreign legal entity write policies that are considered "financial accounts" for US customers?
  - What are the reporting and withholding requirements of PFFI regarding cash value life insurance policies or annuities that are written to US persons or certain entities that are owned by US persons?
- If the business includes legal entities that are FFIs, identify whether any of these entities satisfy the requirements for reduced obligations under FATCA while remaining compliant.
- For all FFIs, conduct an impact assessment on business to identify the gap between current capabilities and the required capabilities to become FATCA compliant.

Administering FATCA Registration

This is a step FIs must take to administer FFI registration and participation in FATCA, based on the regulatory impact assessment results and strategic choices on accounts either compliance or exit. This includes requesting / receiving / recording / retrieving issued Global Intermediary Identification Number (GIIN), being included in the list of Participating FFIs (PFFIs), and gaining certificate of compliance once all pre-existing accounts are reviewed/compliant. Sample processes applicable to this phase:

- Administer FATCA Participation
  - gaining and maintaining compliance with FATCA
- Administer FATCA Registration
  - the registration process for FATCA participation

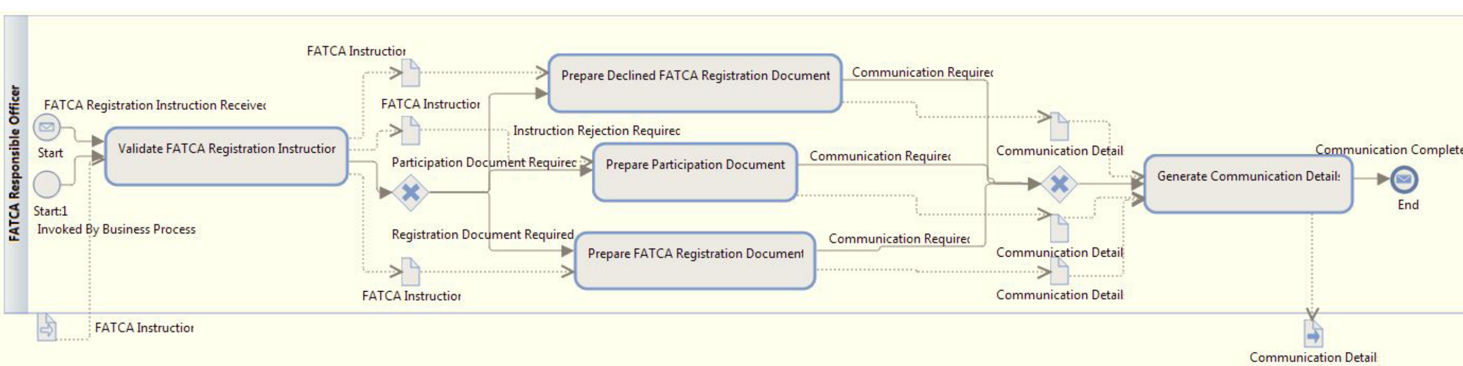

Figure 4. Sample FATCA process

Administer Customer Onboarding Updates
This step is required in order to transform KYC processes to verify status, collect documentary evidence; waivers and tax registration information, update Ts&Cs to accommodate FATCA provisions.

The financial institution must consider its existing KYC and on boarding processes to determine the changes that are required to identify and document US persons, and must develop systems to report on them in accordance with FATCA requirements. Withholding is confined to customers that are NPFFI or recalcitrant account holders.

- Review Involved Party FATCA Details
  - examine involved party information for relevant details affecting FATCA Reporting and compliance
- Identify US Account
  - to prove or decide the beneficiary of an arrangement is a US individual or entity as defined by FATCA regulations.

Reporting FATCA Regulatory Requirements
This step provides annual reports to IRS on US tax-resident account holders, and respond to ad hoc information request. This includes:

- Administer FATCA Reporting
  - periodic and ad hoc reporting of information to the IRS
- Determine FATCA Reporting Requirement
  - to ascertain if there is a requirement to include an arrangement for FATCA Reporting
- Maintain FATCA Documentation
  - perform required maintenance on an involved party's FATCA-related documentation

Administering FATCA Withholding Tax
This step collects withholding tax at source on pass-through payments to recalcitrant accounts and NFFIs. This includes:

Administer FATCA Withholding - application of a withholding tax on identified non-compliant individuals or entities

Service analysis and design

Based on the FATCA support in the Process Analysis Model, a set of candidate services and supporting activities are provided in the Service Analysis Model to support FATCA.

Processes and tasks that are defined in the Process Analysis Model as service candidates have associated Use Cases in the Service Analysis Model. For example:

- Record Customer Reporting Requirement
- Record FATCA GIIN
- Record FATCA Reporting Requirement
- Record Involved Party Score Details
- Retrieve Documentary Evidence
- Retrieve FATCA Details
- Retrieve Involved Party FATCA Status
- Schedule Involved Party FATCA Review

In turn, the Use Cases that are defined in the Service Analysis Model are supported by associated services in the Service Design Model. For example:

- recordCustomerReportingRequirement
- recordFATCAGIIN
- recordFATCAReportingRequirement
- recordIP ScoreDetails
- retrieveDocumentaryEvidence
- retrieveFATCADetails
- retrieveIPFATCAStatus
- scheduleIPFATCAReview

The Service Design Model also contains supporting classes derived from the FATCA content in the Service Analysis Model. For example:

- ComplianceOfficer
- CooperationArrangement
- DeclarationOfTaxationStatus
- RelationshipManager
- Report
- TaxationAuthority
- TaxationComplianceArrangement
- WithholdingAgent

[1] Agarwal, Siddarth. Foreign Accounts Tax Compliance Act - Effectively meeting the compliance challenge." IBM Global Business Services. ©2013.

[2] Kaufman, Marcia; Halper, Dr. Fern; Hurwitz, Judith. "Using Process and Service Model to Help Transform Business Processes in Financial Services Organizations." Hurwitz & Associates. © 2007.

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