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Financial Services Briefings

Issue 02

MICA (P) 160/02/2011

Foreword

Financial institutions in Asia are not immune to the long reach of US legislation.

Since the first issue of Financial Services Briefings, much has happened to rattle global markets. For example, the unrest among the oil producing states of the middle-east and the natural disaster in Japan, the world's third largest economy. More recently, we have heard that Portugal teeters on the verge of a sovereign debt crisis.

Nevertheless, prospects in Asia still look bright for the financial services industry.

In this second issue, our feature focuses on the upcoming Foreign Account Tax Compliance Act (FATCA). This legislation, enacted to prevent offshore tax abuses by US tax-obligated-persons, includes a new withholding tax regime that imposes a punitive withholding tax on foreign financial entities that do not comply with reporting and Know-Your-Client (KYC) requirements.

Soon to come into effect, FATCA requires foreign banks and other financial institutions to provide the U.S. Government with information about the financial holdings of U.S. tax-obligated-persons. Failure to cooperate can trigger stiff penalties, including a punitive 30 percent withholding tax on payments and earnings received from U.S. sources. We offer financial institutions in Singapore some tips on how to get ready.

This issue also provides a high level summary of recent regulatory, tax and accounting changes that are relevant to the financial sector. Of particular interest, are the changes discussed from the recent Singapore Budget 2011 proposals.

A summary of the latest global KPMG publications within the Financial Services practice this past quarter is also presented.

I hope you find our insights of interest. Please feel free to get in touch with me or any of my colleagues if you want more information about the issues discussed herein.

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What you need to know about FATCA

On March 18, 2010, President Barack Obama signed the Foreign Account Tax Compliance Act (FATCA) into law. This legislation, enacted to prevent offshore tax abuses by US-tax-obligated-persons, includes a new withholding regime that imposes a punitive 30 percent withholding tax on foreign persons and financial institutions that do not comply with reporting and Know-Your-Client (KYC) requirements.

It has been a year since the law was enacted and almost two years before the effective date of 1st January 2013. Due to the lead times, there is some room for developing compliance policy and procedure, although this opportunity is shrinking by the day.

Singapore, as a leading Financial Services hub, is directly affected by this law. In addition to banks, FATCA reporting requirements will impact organisations as diverse as insurance companies, hedge funds, investment houses and real estate trusts.

The US Department of Justice's Tax Division has already been aggressively enforcing existing provisions in this area, leveraging the requirements to declare the existence of foreign accounts on IRS tax returns. 2009's landmark deferred prosecution agreement with a major Swiss bank highlighted the risk associated with non disclosure of overseas financial assets to the US tax authorities: An unprecedented 15,000 US persons acknowledged previous non-compliance in 2009, agreeing to significant penalties for so doing. A similarly robust approach to FATCA is all but guaranteed. In all likelihood, some potential targets will already have been identified.

The US Treasury, responsible for regulating the banking sector, has yet to issue final guidance on what exact steps institutions will need to take in order to be deemed FATCA compliant and is still considering submissions that have been made. This is as opposed to the legislated 'what' the Institutions must be compliant with, which is theoretically more clear.

The 18 – 24 months lag from the enactment date is not expected to delay the enforcement of the FATCA rules, particularly when the prize for immediate enforcement is the 30 percent withholding tax regime.

Further, expertise, resources and project experience will all be in short supply as the Treasury moves from the legislative to its enforcement stage with its collection arm, the Internal Revenue Service (IRS).

For affected institutions, KPMG expects FATCA to necessitate changes to their systems' functionality and operational processes.

The basic framework for the new withholding tax regime:

1. A 30 percent withholding tax will be imposed on any withholdable payment made to a Foreign Financial Institution (FFI) that fails to enter into an agreement with the IRS to identify and disclose its US account holders directly to the IRS.

2. Similarly, a 30 percent withholding tax will be imposed on any withholdable payment from a US payer to a Non-Financial Foreign Entity (NFFE) payee if the NFFE fails to certify that it does not have substantial US ownership, or fails to disclose the identity of any substantial US owners.

Waiting for published guidance before taking substantive action would require affected entities to make rushed and possibly flawed implementation decisions. However, there are a number of steps that should be taken now, the first of which is to decide whether to (1) become compliant; or (2) pay 30 percent withholding tax, or (3) close out any US investments.

Therefore, a fundamental decision is required that depends on your institution's appetite for (1) continued US legislative oversight vs (2) a continued 30 percent tax burden or (3) continued US investment opportunities.

Assuming compliance is desired, what should be done today?

What are the unknowns?

1. **The FFI Agreement will require an FFI to identify its US account holders.** What questions must an FFI implement to satisfy this requirement?
   - Will the documentation standard be uniform for all types of FFIs?
   - To what extent will an FFI be able to rely upon the documentation it has already obtained for purposes of its local KYC and anti–money laundering (AML) rules?
   - What documentation standards will be required for FFIs that are not bound by local or USA PATRIOT Act KYC or AML rules?
2. **Will Treasury exempt entities that "possess a low risk of tax evasion"** or will those entities instead be covered by a less rigorous regime? To the extent an entity is excluded from these rules, how will this status be conveyed to the US payer?
3. **How should an NFFE provide information relating to US owners** (or certify that it has none)? What format will any FFI reporting take?
4. **How will the level of compliance achieved** by FFIs and NFFEs be verified?

Given the time it will take to make the systems modifications necessary to become FATCA compliant (approximately 18–24 months), it is imperative for your institution to position itself to be able to react as soon as Treasury guidance is released.

What Now?

There are a number of proactive steps an organisation should consider undertaking immediately. Such steps include:

1. **Educating senior management.** Implementation of FATCA will be complex, onerous and costly. Senior management needs to be made aware of the potential costs and consequences of non-compliance. It is important to obtain senior management buy-in at this early stage.

2. **Identifying all client types that will be impacted by these rules.** For example, institutions providing services providing facilities to US persons or organisations, and institutions with US-investments.

3. **Identifying all business lines and products that may be in scope.** For example, those that employ US citizens and/or US sub-contractors or have US earnings sources or investments *(regardless of earnings)*.

4. **Identifying processes and procedures that impact these clients or products.** Ensure that procedures are in place to capture missing data and consider starting Look-Back reviews to gather data required for continuation of existing services.

5. **Identifying key personnel within each affected business area**, with a view to assembling a core project team. This team should incorporate expertise from a withholding tax and operations perspective, as well as IT and risk specialists.

6. **Carrying out a high-level systems analysis.** This should include a review of core accounting systems to determine whether FATCA reporting is possible with the system. If not, the organisation has to consider upgrading the system so that it can.

7. **Consider potential conflict locations.** While the US government may possibly not enforce compliance locally where there is directly conflicting banking secrecy legislation, this has been done in the past and the risk/reward of continued Business As Usual in a non-compliant jurisdiction requires assessment, as the 30 percent withholding tax will likely be applied regardless of local law for non-compliant institutions. Pre-emptive identification of local country legal issues is a must, whether or not your organisation currently operates in jurisdictions where there are prohibitions on disclosing customer account details.

8. **Promoting client awareness.** FATCA's withholding rules will have a large impact on some clients therefore, education is critical. Depending on the relationship, this education may be as limited as an explanation of changes in the treatment of client accounts or as extensive as conducting formal workshops or one to one meetings with high net worth clients.

Conclusion

Whatever the final regulations may require, ensuring that your organisation will be/is FATCA compliant cannot be viewed as simply an internal tax function project. In order for Foreign Financial Institutions to be compliant, FATCA will mandate significant systems enhancements, a multitude of changes to the controls and procedures utilised when opening new accounts or establishing new relationships, and the reworking of many operational processes. This will require a devoted and multi-functional project team.

How KPMG can help

KPMG is uniquely positioned to assist your organisation with all facets of FATCA compliance. We have created a highly successful Global FATCA network and in Singapore, we are able to call upon US- and regionally-based resources. Currently, in the US, our tax and compliance teams are heavily focused on FATCA developments and the issues these create for regional FFIs. Our team has been very active in both industry groups and in the consultation process with the US Government on FATCA.

Related Issues

- 3rd EU KYC requirements
- Know Your Client's Client (KYCC) developments with Financial Action Task Force (FATF) recommendations
- UK Bribery Act
- FCPA (Foreign Corrupt Practices Act)

Regulatory, accounting and tax updates

Regulatory Updates

Rules on Residential Property Loans

The Loan-to-Value (LTV) limit granted by financial institutions regulated by the Monetary Authority of Singapore (MAS) to non-individuals and individuals was lowered, with effect from 13 January 2011, as part of the Government's efforts to maintain a stable and sustainable property market.

The revised LTV limit of 50 percent applies to residential property purchasers who are non-individuals, including corporations, trusts, collective investment schemes etc.

For individual borrowers who at the time of applying for a housing loan for a new property purchase already have one or more outstanding housing loans (whether from HDB or a financial institution regulated by the MAS), an LTV limit of 60 percent now applies. Borrowers without any outstanding housing loans continue to be subject to an LTV cap of 80 percent.

At approximately the same time, the MAS also issued a consultation paper that proposed changes to the regulatory LTV limits on mortgage equity withdrawal loans (MWL). These are essentially loans secured on the borrower's equity in a residential property. The proposal aligns the LTV limits for MWLs to the same levels set for housing loans as described above.

The consultation paper also proposed that financial institutions be required to aggregate loans from moneylenders for LTV computation that are used to pay for residential property purchases.

The consultation closed in February 2011, and MAS has yet to publish its responses to the feedback received.

Proposal to Regulate Credit Rating Agencies

On 24 March 2011, the MAS issued a consultation paper that proposes the regulation of activities conducted by credit rating agencies (CRAs). The paper proposes that CRAs be licensed under the Capital Markets Services (CMS) licensing regime under the Securities and Futures Act (SFA) and that they be subject to licensing obligations. Licensees who provide credit rating services will be required to comply with existing regulations, guidelines and notices under the SFA that apply to all CMS licensees.

The proposed regulatory regime will also include a Code of Conduct for CRAs. The Code is based largely on the Code of Conduct Fundamentals for Credit Rating Agencies, issued by the International Organisation of Securities Commissions, which aims to promote the quality and integrity of the rating process, strengthen CRA analytical independence, strengthen investor protection and enhance protection of non-public information.

Launch of Private Banking Code of Conduct

A new code of conduct on private banking was launched on 5 April 2011. The code is the result of an industry-led effort to enhance the competency of private banking professionals and foster high market conduct standards. It is applicable to financial institutions and their staff engaged in private banking activities in Singapore. The code has been developed with recommendations from representatives from the private banking industry.

Under the code, private banking professionals are expected to pass a common competency assessment called the Client Advisor Competency Standards before they provide any financial advice. The assessment focuses on broadening and deepening the capabilities of these professionals in the provision of comprehensive private banking services. This assessment will be administered by the Institute of Banking and Finance. In addition, the code sets out market conduct principles relating to the business conduct of financial institutions and their staff engaged in private banking activities. These principles cover areas such as ethics and professionalism, client relationship management and risk management. The code seeks to promote good industry practices and contribute to the long-term sustainable growth of the private banking industry in Singapore.

The code can be accessed on the website of the Association of Banks in Singapore at *www.abs.org.sg*. The code will take effect from 1 September 2011.

Accounting Updates

Supplement to ED/2009/12 *Financial Instruments: Amortised Cost and Impairment*

On 31 January 2011, the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) published for comment proposals for accounting for impairment of financial assets managed in an open portfolio (the Supplement). The proposals are issued as a supplement to ED/2009/12 *Financial Instruments: Amortised Cost and Impairment* published by the IASB and the *Proposed Accounting Standard Update, Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities* published by FASB.

The Supplement discusses the recognition of expected credit losses for financial assets managed in an open portfolio.

In an open portfolio, assets are added to the portfolio and removed from it throughout its life through origination, purchase, repayment, sale, transfer or a write-off. The Supplement proposes that financial assets that are managed on an open portfolio basis are split into two groups: the 'good book' and the 'bad book'. Impairment allowance for the expected credit losses in these books is recognised using different bases and at different timing, based on the credit risk of the respective books.

The Supplement therefore amends the earlier proposal to include expected credit losses in the determination of effective interest rate for interest income recognition. Expected credit losses are now recognised and reported separately from interest income.

The Supplement also sets out the proposed presentation and disclosure requirements of financial assets included in an open portfolio. In addition, the Supplement seeks feedback as to whether loan commitments that are not accounted for at fair value through profit or loss and financial guarantee contracts should also be included in the financial assets portfolio for impairment assessment.

The IASB has invited comments on the proposals contained in the Supplement by 1 April 2011. In Singapore, the Accounting Standards Council (ASC) has issued the Supplement and the comment period closed on 25 February 2011.

ED/2011/ *Offsetting Financial Assets and Financial Liabilities*

On 28 January 2011, the IASB and the FASB issued ED/2011/1 *Offsetting Financial Assets and Financial Liabilities* which contains joint proposals on offsetting financial assets and financial liabilities in entities' statement of financial position.

The proposed requirements would supersede the requirements on offsetting in IAS 32 *Financial Instruments: Presentation*. These

proposed amendments will mostly affect entities reporting under U.S. General Accepted Accounting Principles (GAAP) rather than those reporting under International Financial Reporting Standards (IFRS).

Main proposals:

- Offset of a recognised financial asset and a recognised financial liability would be required only when the entity has an unconditional and legally enforceable right to set-off and intends either to settle the asset and liability on a net basis or to realise the asset and settle the liability simultaneously.
- In all other cases, offsetting would be prohibited.
- Disclosures would be enhanced through improved information about rights of set-off and related arrangements and their effect on the entity's financial position.

The IASB has invited comments on the proposals contained in the ED by 28 April 2011. In Singapore, the ASC has issued the same ED and the deadline for comment closed on 4 March 2011.

Tax Updates

Singapore Budget 2011

Liberalisation of the Withholding Tax Exemption Regime for Banks

Currently, payments which fall under Section 12(6) of the Singapore Income Tax Act (SITA) that are made by approved banks to overseas banks and branches are exempted from Singapore withholding tax by virtue of a Ministerial remission under Section 92(2) of SITA.

It is proposed that the scope of the above said withholding tax exemption be expanded with effect from 1 April 2011 to include Section 12(6) payments made to all non-resident persons (excluding permanent establishments in Singapore) if the payments are made for trade or business purposes. In addition, with effect from 1 April 2011, the payer entities covered would be expanded to include finance companies and other approved entities.

Extension of Tax Incentive Schemes for Project Finance

It is proposed that the sunset clause for the existing package of tax incentive schemes for project finance, other than the Financial Sector Incentive (Project Finance) scheme (FSI-PF scheme), would be extended till 31 March 2017. The FSI-PF scheme will lapse on 31 December 2011.

Enhancement to the Tax Incentive Scheme for Trustee Company

To streamline the tax incentive scheme for trustee companies and align the administration of the incentive with other tax incentive schemes, the Singapore Government has proposed the following changes to the scheme:

- A sunset clause of 31 March 2016 would be introduced
- A 10-year award tenure would be offered to recipients of the scheme approved on or after 1 April 2011
- All existing recipients of the scheme would automatically transit to the new framework on 1 April 2011 for a period of 10-years up till 31 March 2021
- The list of qualifying activities has also been expanded with effect from 1 April 2011.

Renewal of Tax Exemption Scheme for Income Derived from Structured Products

The existing tax exemption scheme for income derived from structured products by non-resident non-individuals will be extended to 31 March 2017.

Extension of tax deduction for Employee Equity-Based Remuneration (EEBR) scheme

It is proposed that with effect from the Year of Assessment (YA) 2012, tax deductions would be granted for costs incurred by a company to acquire its parent company's treasury shares through a special purpose company for fulfilling its obligations under its EEBR scheme, subject to conditions.

Enhancement of the Finance and Treasury Centre Incentive

It is proposed that related party transactions would now be excluded from the calculation of annual total revenue to determine the revenue ratio for the purposes of ascertaining whether a Singapore company qualifies as approved network company.

A sunset clause of 31 March 2016 was also introduced in respect of new applications under the Finance and Treasury Centre incentive.

Introduction of Foreign Tax Credit (FTC) Pooling System

A FTC pooling system would be introduced with effect from the YA 2012 to support businesses that are globalising and earning a large share of their income overseas.

Under the FTC pooling system, FTC would be computed on a pooled basis (rather than on a source-by-source and country-by-country basis for each particular stream of remitted foreign income), subject to conditions.

The amount of the FTC granted would be based on the lower of the aggregate foreign taxes paid or the aggregate Singapore tax payable on the pooled foreign income.

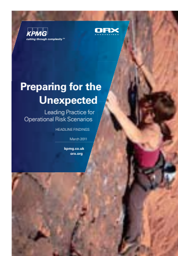
Global topics

The New World for Insurance: Business Perspectives on Phase II

This publication focuses on the business impact for the insurance industry in transitioning to Phase II of the insurance accounting standard and is based on the views of leading global insurance companies with headquarters in eleven countries (and operations throughout the world).

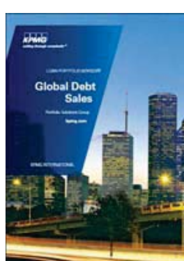
Evolving Insurance Regulation - March 2011

Produced by the Regulatory Centre of Excellence, this report takes a fresh look at various regulatory reform initiatives in the insurance sector.



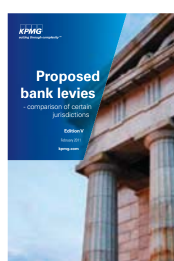
Preparing for the Unexpected - Leading Practice for Operational Risk Scenarios

This report, produced in association with ORX Association, is based on interviews with operational risk specialists at the 40 biggest global banks.



Global Debt Sales

This is the first edition of a report that analyzes recent debt portfolio activity in a number of banking markets across Europe, the Americas and APAC. It also examines a variety of debt sales and provides high-level insights into existing trends and new opportunities.

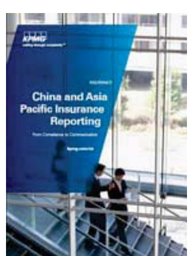


Proposed Bank Levies: Comparison of certain jurisdictions

There are a number of inconsistencies in the approaches taken by governments that have announced or started to implement bank levies. This report highlights these inconsistencies with a comparison of the various plans.

New on the Horizon: Impairment of financial assets in an open portfolio

This publication contains detailed observations on the proposals contained in the Supplement to ED/2009/12 Financial Instruments: Amortized Cost and Impairment, which was published on 31 January 2011.



China & Asia Pacific Insurance Reporting – From compliance to communication

Inaugural review of International Financial Reporting Standards (IFRS) for 2009 and the half-year 2010 of 10 significant insurers with operations in China and Asia Pacific. It discusses how they are using their annual report to communicate their strategy, performance and prospects.

Frontiers in Finance - Taking Control, Jan 2011

Financial institutions must create stability and avoid future crises while facing a complex and changing regulatory environment. In these uncertain times it is imperative for businesses to find a way forward by quickly grapping the impact of regulatory changes.

IFRS Illustrative financial statements- Investments funds (December 2010)

A publication produced by the International Standards Group to assist with the preparation of investment funds financial statements in accordance with IFRS.

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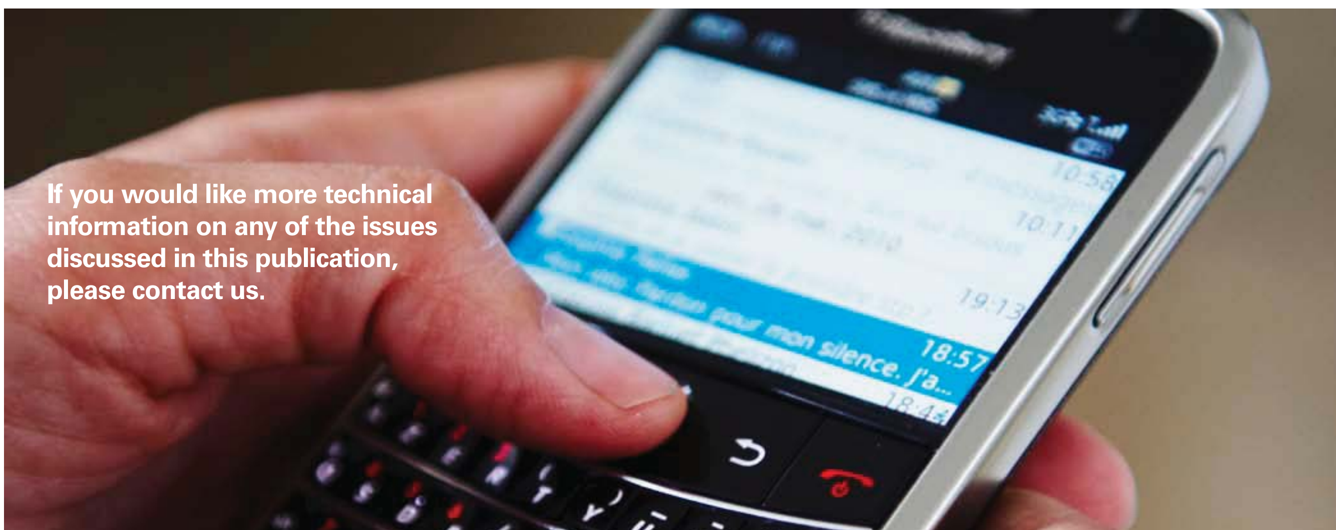

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