Building Societies Association

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Mr John Sweeney
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Dear Mr Sweeney

I am writing to you on behalf of the United Kingdom's Building Societies Association to offer high level comments on REG-121647-10, the regulations relating to information reporting by foreign financial institutions and withholding on certain payments to foreign financial institutions and other foreign entities. We welcome the opportunity to take part in this consultation.

We also welcome the intergovernmental approach to the Foreign Account Tax Compliance Act implementation announced on 8 February, in particular, its recognition of the need to keep compliance costs as low as possible, achieve common reporting and due diligence all through a common approach. But in some cases, there is a need to accommodate jurisdictional variations to deliver consistent data requirements and reporting frameworks – for this, we endorse the British Bankers' Association's proposal for a country specific attachment as established with the partnership government.

We are concerned about the timing of the final FATCA regulations, the partnership agreement and UK's Finance Act 2013, which implements the terms of the partnership agreement in this country. UK institutions are working towards solutions based on draft IRS regulations and unseen UK legislation, both of which may change with only very limited time for institutions to absorb and apply any such late changes. Accordingly, we propose that the timescale be amended so that there is a minimum 12 months from publication of the applicable final regulations before the application of any compliance requirements.

Executive summary

Option A – our preferred option

We continue to argue that BSA members such as building societies are very low risk – they are akin to savings and loans institutions - and should therefore be excluded from FATCA provisions. They have a very low number of possible US taxpayers, estimated at 3,000 out of a total of over 20 million[1] savers. This **0.0002%** of building society savers are legacy UK customers who may have moved to USA or the potentially low number of US persons who now live in the UK and have accounts (in this case, UK tax is always withheld from these accounts). Exclusion would be a proportionate response.

[1] Building Societies Yearbook 2011-12 operational information

Option B

We present a range of suggested changes that will help the IRS gain the information on US taxpayers it seeks and also reduce the burden for UK financial mutuals:

- If exclusion is not possible, we suggest that small and medium-sized building societies should be able to become “non-registering local banks”.

- We also suggest that the remaining larger building societies should be able to obtain local registered deemed compliant FFI status, subject to a minor modification to the regulations.

- We would like consistency in the *de minimis* limits.

- We propose that reporting of US accounts to the UK tax authority, HMRC, for onward transmission to the IRS should be in line with current reporting of European accounts.

- We welcome the fact that the "explanatory" preamble to the proposed Treasury regulations suggest that an FFI will generally not have to make significant changes to the information collected during the account opening process in order to identify US accounts. Since the legislation requires institutions to obtain particular types of documentary identification, the realty is, however, that virtually all FFIs will have to make significant and costly changes to their onboarding procedures. We therefore suggest ways to make the information collected from new customers at account opening more useful to IRS - and potentially less onerous to UK institutions. We welcome the requirement that that FFIs may rely on the documentation obtained under existing KYC/ AML procedures. We suggest ways to make the information collected from new customers at account opening more useful to IRS – and potentially less onerous to UK institutions.

Introduction

The Building Societies Association represents mutual lenders and deposit takers in the UK including all 47 UK building societies. Mutual lenders and deposit takers have total assets of over £375 billion ($610 billion) and, together with their subsidiaries, hold residential mortgages of almost £235 billion ($382 billion), 19% of the total outstanding in the UK. They employ approximately 50,000 full and part-time staff and operate through approximately 2,000 branches.

UK building societies are mutual organisations, owned by their members, similar to but not the same as, savings and loans institutions; membership is achieved by becoming a mortgage or a savings customer (or both). Building societies and other financial mutuals currently fall within the definition of foreign financial institution.

Option A

The majority of building societies operate straightforward savings and mortgage accounts. Few operate current (checking) accounts. A minimum of 75% of their lending must be in residential mortgages. Building society law forbids them to take risk positions in commodities, currencies or derivatives. They are not in the business of offering complex structured transactions such as inheritance tax planning or involve themselves in opaque remuneration practices. Their business models are therefore simple and their members local.

UK building societies open accounts only for UK resident individuals (or trusts). They are very low risk in FATCA terms as:

- the only non-resident accounts[2] held are for UK residents who have moved abroad since opening their account, and for members of the armed forces.
- non-resident account applications are declined.
- UK income tax is withheld from interest on all individuals' savings accounts[3], whether UK resident or not.

To comply with FATCA - even as "deemed compliant" - would be a massive, expensive and disproportionate exercise for the very low number of legacy UK customers who may have moved to USA or the potentially low number of US persons who now live in the UK and have accounts - *but UK tax will always be withheld from these accounts in any event*. Most likely, however, the outcome would be a nil return or a low number of accounts with modest balances and interest receipts. Early indications are of around 3,000 customers who may be affected out of a total of 20 million plus, representing a minuscule 0.0002% of the total. The costs to the building societies alone could run into thousands of pounds for **each account** found and reported on.

The average member balance[4] is low (£12,032 or $19,571 for the top 13 societies; £8,671 or $14,104 for the 23 in the second tier and; £11,656 or $18,959 the 12 in the third tier). Figures for February 2012 show an average of £6,500 ($10,573). Most societies have a maximum limit on account balances.

Given that UK tax is withheld from all savings accounts, we believe that there is no risk of avoidance. The cost of being able to certify that there are no US persons holding accounts, or to identify the very few who do hold balances, is out of all proportion to the cost of adapting and interrogating the societies' systems to make the reports required. Any such charges will have to be passed on to the individual member in terms of lower savings and higher mortgage rates. This would have an impact the sector's ability to remain competitive in the UK.

We therefore propose that the US Treasury and IRS consider the exclusion of UK financial mutuals such as building societies from the provisions of FATCA.

Option B

1. Non-registering local banks

To become a non-registering local bank, an institution must not exceed an asset threshold of $175 million. We would appreciate knowing how that threshold was calculated. This is because we believe it needs to be raised. Few local domestic institutions have assets that low. For example, currently only six[5] building societies would meet that criterion. Indeed, the UK government's flagship alternative small bank, The Big Society Bank, would also fail. To exclude more low risk mutuals from FATCA regulations, we believe that limit should be raised to a minimum of $1,500 million with no more than 250 full-time equivalent staff.

While a few societies may not meet the requirement to have less than $50,000 per account, they all meet the remaining requirements ie they do information report and they do withhold tax, even on non-residents' savings income.

[2] A few large building societies, along with other mutuals, have separate non-UK banking subsidiaries where **non-UK residents** can open **non-UK** accounts.
[3] With the exception of tax-exempt products such as cash ISAs.
[4] KPMG Building Societies Database 2011 (when there were 48 building societies in operation)
[5] Earl Shilton, Ecology, Penrith, Shepshed, City of Derry and Century.

Many of the smaller mutuals have small staffs, several without a full-time finance director. Some of those deemed **too big** to be non-registering local banks have under 20 staff and fewer than 10,000 investing members. The burden of FATCA compliance would hit them hard and – more importantly – not generate any useful information for the IRS.

An alternative and workable requirement would be for non-registering local banks to have on average less than $15,000 per investing member. The requirement in the UK to have a “single customer view”, introduced by the regulator, the Financial Services Authority, initially to speed through any compensation payment, means that institutions will be able to produce such aggregate data. Adopting this alternative requirement would identify clearly those institutions whose customers have small amounts of savings.

2. Eligibility for local registered deemed compliant FFI status

Several domestically-focused building societies may be required to become participating FFIs although they have no US business or assets. A pragmatic solution would be to permit them to become registered deemed compliant FFIs (RDCFFIs) as local FFIs by altering the terms of Regulation 1.1471-5(f)(1)(A):

- (2) “fixed place of business” to be interpreted as all EU /EEA, not just country of incorporation/organisation; and
- (8) “same country” to be interpreted as all EEA (to include crown dependencies) and all other countries with which US has a FATCA agreement, not just country of incorporation/organisation - or this subsection to not apply where other members of the expanded affiliated group are PFFIs (participating FFIs).

We also challenge the IRS’s criteria (Regulation 1.1471-5(f)(1)(i)(8) for RDCFFI status. As it stands, all members of the expanded affiliated group must be organised in the same country. We do not see any risk to the IRS if an RDCFFI is based in one country and a participating FFI within the same group is based in another.

3. Consistency in *de minimis* limits

We would appreciate clarification on the basis of the $50,000 proposed *de minimis* for individual customers and how it was calculated. In the UK, there is no level – not public at least – at which savings are considered to be in danger of harbouring untaxed income. There is a level, however, to which retail deposits are protected by the state compensation scheme. That is £85,000 ($135,000) per account at each regulated institution.

We note the revised figure for *de minimis* for entities, which we welcome. But we consider that there is a need for consistency here – we cannot see the reason for the different levels. We believe, therefore, that the *de minimis* for new and existing accounts is raised in line with entities ie to $250,000.

4. Reporting mechanism

Under the EU Savings Directive, individual investors resident in EU member countries and certain other countries are subject to tax reporting. The main purpose of the directive is to allow a taxpayer’s national tax authority to identify that the taxpayer is in receipt of savings income which may otherwise not be declared, rather like the purpose of FATCA. The directive ensures that “paying agents” in one EU member state either report interest income received by taxpayers resident in another member state or (in certain jurisdictions) levy a withholding tax on that income.

This system has worked well. We believe EUSD could be extended in the EU to cover FATCA information. We recognise such a move has been declined in the past by the US authorities but we urge the IRS to reconsider. It would minimise costs for financial institutions affected as they would not have to set up new systems.

5. Onboarding requirements

We welcome the fact that the "explanatory" preamble to the proposed Treasury regulations suggests that an FFI will not have to make significant changes to the account opening process in order to identify US accounts ie may use existing KYC/ AML procedures. UK KYC/AML allows financial institutions to use an auto identification (auto ID) method of verifying the identity of persons opening low risk accounts. Certain information, such as name and address can be submitted electronically by the account opener, which the financial institution then passes on to a credit rating agency. If a certain score is achieved based on checks by the credit rating agency, then an account is opened.

It has been suggested that as far as onboarding individual customers is concerned, the IRS requires a Form W-8 or W-9 to be obtained or government-issued documentary evidence that would be reviewed to check for US indicia. Clearly, for FFIs, not just building societies, collecting such documentary evidence for all new accounts would be retrograde and leave FFIs potentially open to fraud and forgery. Documentary evidence is seen as a weaker control than e-identification. Using documentary evidence would also be an expensive, resource hungry process that would delay account opening.

In the UK, auto ID is confirmed as being satisfactory for identification and verification in the Joint Money Laundering Steering Group Guidance Notes, which have been approved by HM Treasury. Section 5.3.38 of the JMLSG guidance notes refers:

For an electronic check to provide satisfactory evidence of identity on its own, it must use data from multiple sources, and across time, or incorporate qualitative checks that assess the strength of the information supplied.

For example, Experian, used by over 200 financial institutions in the UK, meets those requirements.

Should our auto ID procedures not fully satisfy IRS requirements, we have identified two ways to remedy that situation with a reduced – but not eliminated – burden for financial institutions such as building societies.

Onboarding option A

The local RDCFFI criteria (see 1.1471-5(f)(1)(i)) incorporates a distinction between resident and non-resident persons, generally providing that an FFI must have policies and procedures to prevent it from opening or maintaining accounts for a US person who is not resident in the country of the FFI provided that the FFI is in a country that requires information reporting or tax withholding with respect to accounts held by residents. We interpret this as a tolerance for resident customers not being subject to FATCA reporting if they are subject to local information reporting and withholding.

We consider that information collected under auto ID could be used to help identify and distinguish between UK and non-UK residents (and further to filter non-resident US account holders) because the UK requires this activity in order for FFIs to submit an information report[6]. It is worth re-stating here that building societies do not accept non-resident customers (except in a few specific cases, such as for members of the UK armed forces). Therefore, only persons resident in the UK would pass auto ID.

With some flexibility on the layout of a substitute Form W-8BEN and on how information is captured (for example, specified in the FFI agreement), an FFI could potentially agree to change onboarding in a way that questions are asked to complete an electronic/ substitute W-8BEN (effectively part I with name, address, etc).

[6] Known as section 17 report

Thus, in concept, every resident account holder would complete an electronic/ substitute Form W-8BEN (or Form W-9 where appropriate) as part of onboarding and ideally it could be done in an unobtrusive way where it would be signed electronically. This would mean the FFI will have documented every new individual account holder for US tax purposes.

On the issue of refreshing Form W8-BEN (whether paper or electronic) or other documentary evidence, an FFI would use auto ID either periodically or when there is reason to believe that a person's residential status may have changed to look for US indicia. If US indicia are found, an FFI would take further action and seek the appropriate confirmatory documentation.

Onboarding option B

The British Bankers' Association has shared with us its views on onboarding. It too sets out a need to continue to the established practice of relying on third party AML/ KYC due diligence processes where they are undertaken by a regulated party within the jurisdiction of The Third EU Money Laundering Directive and the UK Money Laundering Regulations 2007, and the guidance notes issued by the Joint Money Laundering Steering Group giving detailed guidance on how to conduct these checks. This allows for financial institutions to rely on regulated firms to undertake customer due diligence (CDD), including identification and verification. This will now have to incorporate a search for US indicia excluding telephone numbers – it follows that we support the BBA representation about the inherent difficulties in identifying US telephone numbers. An FFI which relies on the CDD checks performed by a regulated third party still retains liability for due diligence.

While the BBA solution differs slightly to our own, we believe it also merits consideration.

Way forward

We remain willing to discuss further any or all of the points above with you or colleagues. Similarly, if you require further information, please do not hesitate to contact us.

Yours sincerely

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