Latest FATCA/CRS Guidance: Changes relevant to the asset management industry

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What you need to know

- Most participants in Canada's asset management industry are Canadian financial institutions (FIs) that are subject to due diligence and reporting obligations in respect of the *Foreign Account Tax Compliance Act* (FATCA) and the *Common Reporting Standard* (CRS) as set out in Parts XVIII and XIX of the *Income Tax Act*[1] (ITA), respectively.
- On March 10, 2022, the Canada Revenue Agency (CRA) released updated guidance on Parts XVIII and XIX of the ITA (collectively referred to as the Latest Guidance) that impact these FIs.
- This article addresses the changes in the Latest Guidance that affect arrangements where multiple FIs maintain the same account.

The Latest Guidance also clarifies or amends the CRA's administrative positions on FATCA and CRS compliance issues that impact FIs more broadly. To see our discussion on these other changes, please refer to our article *Latest FATCA/CRS Guidance: What Canadian financial institutions need to know.*

Overview of the changes in the latest guidance

1) Penalties for missing self-certifications and effective measures

FIs are required to obtain a self-certification from the account holder at account opening[2] or within 90 days of a "change in circumstances"[3]. Failure to obtain a self-certification may subject the FI to a $2,500 penalty under each of FATCA and CRS (for a maximum cumulative penalty of $5,000 for each undocumented account).

In the Latest Guidance, the CRA states that it will not assess the penalty on FIs that take "effective measures" to obtain a self-certification from the account holder. The CRA states that an "effective measure" may include closing or freezing existing accounts with missing self-certifications and not opening new accounts with missing self-certifications.

For the asset management industry, this new reference to "effective measures" in the Latest Guidance is perhaps the most important. In particular, the "closing" or "freezing" of accounts (both of which are not defined in the Latest Guidance) should not be undertaken lightly by FIs that are limited in their actions by their legal documents with clients, their fiduciary responsibilities, as well as securities rules.

2) Client name accounts

Securities of an investment fund are either issued in the name of the beneficial owner (*i.e.,* client name accounts) or recorded in the name of the dealer (*i.e.,* nominee name accounts). The CRA's administrative position has changed only in respect of the former, as discussed below.

Client name accounts may be subject to duplicative due diligence and reporting obligations by multiple FIs. To avoid duplicative efforts by the various FIs relating to the same account, the ITA offers investment funds (and other FIs) relief from having to perform due diligence in connection with a security held in client name that is also contained in an account of a dealer that is an FI (the Client Name Relief).[4] Under the Client Name Relief, investments funds (and other FIs) do not have to conduct their own due diligence with respect to the client name accounts, but will generally have to report any accounts identified as reportable by the dealer.

The Latest Guidance sets out the following four requirements in order for FIs to take advantage of the Client Name Relief:

- The property recorded in the account maintained by the investment fund is also recorded in the account maintained by the dealer;
- The dealer is authorized under provincial legislation to (i) engage in the business of dealing in securities or any other financial instrument or (ii) provide portfolio management or investment advising services;
- The dealer has advised the investment fund on whether the account is reportable; and
- It is not reasonable for the investment fund to conclude that the dealer failed to comply with its due diligence obligations.

Under the prior Guidance, where there was a written agreement between the investment fund and the dealer relating to compliance with FATCA and CRS, the investment fund could rely on notifications from the dealer that the dealer had provided to the investment fund only the account status of the reportable accounts. In other words, if the dealer did not provide any notification to the investment fund with respect to an account, the investment fund was able to assume that the account was not reportable. Under the Latest Guidance, the CRA has removed the ability for investment funds to rely on a written agreement between the parties in order to conclude that an account is not reportable if no notification was received from the dealer on the account's status. Instead, the Latest Guidance requires the dealer to specifically inform the investment fund of each account's status. This means the investment fund must receive notification on whether the account is reportable – it cannot assume that an account is not reportable simply because it received no notification from the dealer.

Furthermore, the Latest Guidance states that in the case of a new account or where there is a change in circumstances related to an existing account, and the fund is notified by the dealer of its determination of the reportable status of the related account, the fund can only rely on the dealer's determination if it reasonably concludes that the dealer has not failed to comply with its due diligence obligations based on its review of the available information (including the information received from the dealer). If it can be reasonably concluded by the investment fund that the dealer failed to comply with its due diligence obligations, the investment fund must conduct its own due diligence. Alternatively, in the case of a new account, the investment fund can refuse to open the account until it is satisfied that the dealer conducted its due diligence and has obtained a self-certification. The Latest Guidance on FATCA provides the following example for illustration:

> In the case of an existing client name account with the fund where the account was not reportable, the dealer informs in writing or through a systemic/electronic notification to the fund of a change of address for the client in the U.S. and that the account is a U.S. reportable account based on the new self-certification or any other documentation obtained by the dealer. In such a case, had the dealer only provided a new address in the U.S. without any classification, the fund would need to get more information from the dealer as to whether the account is a U.S. reportable account or conduct its own due diligence.

In essence, under the Latest Guidance, in order to avail themselves of the Client Name Relief, investment funds have to perform their own due diligence on dealers in order to avoid the imposition of the above-described penalties which the parties are separately, and not jointly and severally, liable for in respect of the same client name accounts. In fact, given the greater line of sight that the CRA has with the investment funds who are responsible for the reporting as opposed to the dealers in respect of client name accounts, it is more likely that investment funds will be the subject of FATCA and CRS compliance audits which may result in the imposition of penalties. As a result, depending on the level of comfort an investment fund has with a particular dealer, they may be forced to obtain their own self-certifications in client name account situations, which is what the Client Name Relief was intended to avoid.

3) Investment managers and custodial institutions

Institutional account holders often engage the services of an investment manager and custodial institution independently (the IM-Custodian Scenario).

In the IM-Custodian Scenario, investment managers were previously exempt from FATCA and CRS if the custodian provided the investment manager with written confirmation that it will comply with FATCA and CRS in respect of the accounts. This administrative position recognized that both the investment manager and the custodian generally had an obligation to complete AML/KYC procedures independently in relation to the same institutional account holder. Where the investment manager had written confirmation from the custodian, the CRA stated that the investment manager would not be treated as maintaining the account for purposes of FATCA and CRS (the Investment Manager Relief).

The Latest Guidance has removed the Investment Manager Relief. Instead, the investment manager and custodian are expected to utilize the Client Name Relief discussed above. This change in the Updated Guidance will be significant for those investment managers that are presently relying on the Investment Manager Relief.

Those investment managers will now have until the end of this year to put in place internal procedures to accommodate their new FATCA and CRS responsibilities.

4) Introducing broker and carrying broker arrangements

An Investment Industry Regulatory Organization of Canada (IIROC) investment dealer (the Introducing Broker) may enter into an agreement with another IIROC investment dealer (the Carrying Broker) to have the Carrying Broker fulfill the Introducing Broker's due diligence and reporting obligations.

In the prior Guidance, the allocation of the due diligence and reporting obligations between Introducing Brokers and Carrying Brokers was more nuanced. In particular, there were different rules depending on the "type" of arrangement (as determined under the IIROC rules) between the Introducing Broker and the Carrying Broker.

In the Latest Guidance, the treatment of these arrangements has been streamlined so that there is only one set of rules that apply. The Latest Guidance provides that the Introducing Broker remains responsible for the due diligence and reporting obligations notwithstanding the fact that it has contractually delegated its obligations to the Carrying Broker.[5]

5) Effective date of the changes

The change discussed above in item one dealing with effective measures as a defence to the imposition of penalties is effective as of March 10, 2022 (*i.e.,* the Latest Guidance's publication date).

The changes discussed above in items two through four dealing with arrangements between multiple FIs are effective on a prospective basis beginning on Jan. 1, 2023 (the Effective Date). In other words, existing accounts do not have to be remedied to reflect the changes discussed above.[6]

As pandemic restrictions ease, we expect the CRA to begin commencing on-site audits of FIs for FATCA and CRS compliance. In order to avoid any non-compliance penalties, it is imperative for FIs to ensure that their internal policies and procedures are consistent with the Latest Guidance.

Please contact the authors if you have questions on how your FI's internal policies and procedures should be amended to reflect the Latest Guidance.

[1] RSC 1985, c 1 (5th Supp).

[2] As noted in the Latest Guidance, there are limited circumstances where it is not practically possible to obtain a self-certification during the account opening process, e.g., where an insurance contract was assigned from one person to another, or where an investor acquires shares in an investment trust on the secondary market. In these limited circumstances, the self-certification may be obtained within 90 days from when the account is opened. FIs must validate the self-certification as quickly as feasible after it is collected, but in any event, within 90 days from when the account is opened.

[3] A change in circumstances occurs when the FI obtains any information that causes it to know or have reason to know that the original self-certification is incorrect or unreliable. For example, an account holder, whose self-certification on file states that her only jurisdiction of tax residence is Canada, informs the fund manager of her new mailing address in Germany.

[4] A client name account can also exist in circumstances outside of the investment fund and dealer scenario. For example, investment managers or portfolio managers may have client name accounts that result from financial assets being custodied with a custodial institution. The Client Name Relief also applies in respect of these scenarios.

[5] The only exception to this is in the cross-border context where the Introducing Broker is a foreign FI. In such a scenario, the Canadian Carrying Broker (and not the foreign Introducing Broker) is responsible for fulfilling the due diligence and reporting obligations.

[6] However, if an existing account has a change in circumstances arising on or after the Effective Date, FIs must deal with the change in circumstances in accordance with the new rules described in this article.

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