Partnership Targets FATCA-Compliance for Syndicated Loans; CLOs

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Trade Settlement Inc. (TSI) and Finomial Corp. have teamed up to make it a lot easier for fund managers and agent lenders in the syndicated loan and collateralized loan obligation markets to comply with the US Foreign Account Tax Compliance Act (FATCA).

TSI, the New York-based operator of an automated settlement platform for syndicated primary and secondary par and distressed loans, will be marketing Finomial's licenced software to TSI's fund manager customers, loan administrators and agent banks so they can streamline investor on-boarding, complete tas forms, and continually monitor customer accounts. The goal of FATCA is to prevent -- or even catch -- US persons trying to evade their US taxes and the IRS has left it up to financial intermediaries, such as fund managers, banks and broker-dealers, to do the necessary legwork or be financially penalized.

"Finomial's partnership with TSI enables us to serve the CLO and syndicated loan markets, where FATCA's requirements are particularly complex," says Meredith Moss, chief operating officer in New York for Finomial, an investor services software firm in New York. "The CLO and syndicated loan market relies on TSI for its back-office processes, so it's only natural that firms are looking to TSI for help in complying with FATCA."

Instead of building in-house applications for managing the necessary information and workflow procedures, or even worse doing the work manually, TSI's customers can now rely on an out-of-the-box fully automated and auditable FATCA compliance tool.

Fund managers, who invest in CLOs, must be able to track down just who owns the CLOs and verify whether or not they meet the criteria for being US investors holding US-sourced income. If they do, their names and holdings must be reported to the US tax authority, or in some cases a foreign tax agency. If that doesn't occur, the fund manager will be hit with paying a whopping 30 percent withholding tax on all of the US-sourced income.

In the case of syndicated loans, the original lender -- a fund manager of bank which has bought a percentage of the total loan made to a corporate borrower -- must comply with FATCA or also be penalized with a 30 percent withholding tax on interest, fees, principal repayment proceeds, and sales proceeds. In subsequent secondary trading, where the original lender sells some portion of the loan inventory, the original lender may be required to "gross-up" or pay the buyer the full amount of interest.

Secondary syndicated loans,a popular financing tool for corporations, are traded at par or close to par, while distressed loans, a category of syndicated loans also affected by FATCA, are traded at far below par. Collateralized loans represent the collateral held by a large percentage of the loan investor base.

"FATCA affects the primary and secondary syndicated loan market and CLOs very hard," says Pat Loret de Mola, chief executive of TSI, which has just upgraded its loan settlement platform to fully automate the entry of trade details, verification of know-your-customer information as well as customer tracking and reporting.

Syndicated loans originally entered into before March 2012, were set to be grandfathered from the FATCA rules, but the IRS recently announced an extension of the exemption until January 1, 2014. However, as Loret de Mola notes, because syndicated loans are frequently amended, loans which might otherwise be grandfathered could easily become subject to FATCA.

Making the task of complying with FATCA's requirements so difficult for fund managers investing in CLOs and syndicated loans is that they will have so little time to prepare. Although FATCA's effective implementation date is just around the corner, the IRS is still ironing out the final nitty-gritty details of how FATCA applies to syndicated loans and CLOs. Fund managers owning non-US syndicated loans, will be the most impacted because they will be required to register with the IRS and follow FATCA's rules, unless there is an intergovernmental agreement in place between the US and the foreign country where the loans were set up. Even so, the rules for customer onboarding, monitoring and reporting are likely to be pretty similar with the notable exception that reports will be sent to the foreign country's tax authority and not the IRS.

Fund managers owning CLOs will likely to be far more affected than those owning syndicated loans, because most CLOs are incorporated in the Cayman Islands; those incorporated in the US will not be impacted. So far, the IRS has decided that new CLOs, incorporated in the Cayman Islands or any other foreign country after January 1, 2014 must either meet FATCA's requirements or those of intergovernmental agreements, likely to be quite similar. Existing CLOs will be affected as of January 1, 2017.