

Basic Steps to FATCA Compliance by CLOs

MARCH 26, 2014

After four years of sluggish evolution since FATCA was enacted in the Spring of 2010, it is now time for CLO managers to undertake certain specific activities to ensure that the CLOs they manage are compliant with the new FATCA reporting requirements in advance of withholding tax being imposed on payments from U.S. payors to the CLOs later this year. Following the issuance by the Internal Revenue Service ("IRS") of a second set of FATCA regulations last month, most, though not all, of the questions regarding compliance have been settled.

Based upon our knowledge of the rather massive amount of material that has been released by the IRS regarding FATCA, our biweekly conference calls over the past year with the major U.S. financial institutions regarding their approach to FATCA, and our ongoing dialogue with the Caymans counsel who now will have a significant role in FATCA compliance after the FATCA Intergovernmental Agreement ("IGA") was entered into between the United States and the Cayman Islands, we would advise CLO managers to undertake the following activities regarding FATCA compliance:

1. For every CLO 2.0 that is "FATCA ready" (i.e., the CLO documents contemplate compliance with FATCA), the CLO issuer should register with the IRS as a Reporting Model 1 FFI domiciled in the Cayman Islands no later than April 25, 2014.

a) Registering by that date will ensure the CLO is issued a Global Intermediary Identification Number ("GIIN") in time to be included on the IRS-confirmed list of GIINs prior to the July 1, 2014 effective date for the FATCA withholding tax on certain loan payments. Although CLOs domiciled in countries such as the Cayman Islands that have entered into an IGA with the U.S. have until the end of this year to register with the IRS to obtain a GIIN, it is the current thinking among most U.S. financial institutions that having CLOs register now in order to have the GIIN in hand prior to July 1st will be less stressful for both U.S. payors and CLOs.

b) Registration on the IRS website should be undertaken on behalf of the CLO by the Caymans counsel that participated in the initial CLO transaction.

c) If requested by its CLO manager clients, Winston & Strawn can provide to the Caymans counsel a letter advising the Caymans counsel that the CLO is eligible under its documents to register as a Reporting Model 1 FFI. We will also oversee the work of the Caymans counsel to the extent necessary to ensure FATCA

compliance and will advise the manager with respect to procedures proposed to be instituted by Caymans counsel regarding ongoing FATCA compliance (e.g., obtaining new account information).

d) As a Reporting Model 1 FFI, each CLO will work with Caymans counsel to designate a member of its board of directors in the Caymans to be the authorized person for FATCA compliance activities, including signing a Form W-8BEN-E to provide to U.S. payors, with the GIIN included, prior to July 1, 2014.

2. For each CLO that is not FATCA ready (i.e., likely to include most pre-2011 CLO transactions), it will be necessary to undertake a document review to determine whether the CLO documents authorize its board of directors to cause the CLO to engage in the procedures necessary to comply with the FATCA reporting and registration requirements and to require the holders of the CLO's securities to comply with information reporting requirements.

a) For each CLO that is not FATCA ready but contains authorization in its documents for the directors to cause the CLO to comply with FATCA, it may be necessary for the Caymans board of directors to amend the basic CLO documents to authorize compliance with FATCA.

(i) Once the necessary amendments to the CLO documents have been put in place, the CLO will have become FATCA ready and should follow the steps above for other FATCA ready CLOs.

b) For each CLO that does not have the requisite authorizations to comply with FATCA, it will be necessary to compile a list of all non-loan assets contained in the CLO's portfolio.

(i) If the portion of the portfolio consisting of non-loan assets is less than 20% by value, the CLO should be eligible for an exemption from FATCA as a Limited Life Debt Investment Entity ("LLDIE").

(A) If requested by its CLO manager clients, Winston & Strawn can provide to Caymans counsel a letter advising them that the CLO qualifies for the LLDIE exemption from FATCA.

(B) The designated director for the CLO who is authorized to undertake FATCA activities will provide to U.S. payors on behalf of the CLO a Form W-8BEN-E stating that the CLO is a Certified Deemed Compliant FFI. No registration with the IRS to obtain a GIIN will be necessary.

(ii) If the portion of a CLO's portfolio consisting of non-loan assets exceeds 20% by value, it may not be possible for that CLO to become FATCA compliant. In that situation, the CLO would need to avoid ownership of any loans that close, or are significantly modified, after June 30, 2014.

(iii) Note that as a CLO winds down, and loans are paid off, especially if its portfolio endured a significant amount of distress, it may become increasingly likely that 20% or more of the value of the CLO's portfolio will consist of non-loan assets. If that is the case, a CLO that once qualified as an LLDIE may no longer so qualify.

The foregoing general summary is not intended to constitute the formal advice of Winston & Strawn LLP with respect to FATCA compliance by any particular CLO. Managers should consult us or other counsel knowledgeable in this area with respect to the specific circumstances relevant to each CLO.

Please contact Dennis Kelly at (312) 558-5986 or any of the corporate attorneys listed below if you would like to further discuss our assistance with regard to these FATCA compliance matters.

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