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## *A new playing field: The convergence of tax regulations with other global risk*

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### *In brief*

Regulators across multiple jurisdictions are increasing their focus on customer due diligence with respect to Anti-Money Laundering (AML) and Counter Financing of terrorism (CFT), economic sanctions non-compliance, and more recently, tax evasion. Though AML/CFT and Know Your Customer (KYC) requirements have been in place for over 15 years, recent changes, such as updates to Notice 626 issued by Monetary Authority of Singapore (MAS) and the increased KYC complexity resulting from new and evolving sanctions regimes (e.g. Russia/Ukraine), continue to raise compliance standards across the financial services industry.

These new AML/CFT requirements and the increase of sanctions for failing to comply coincide with the issuance of new KYC-like requirements from multiple tax authorities around the world. The enactment of provisions related to the US Foreign Account Tax Compliance Act (FATCA), designed to detect and deter tax evasion by leveraging KYC and other client information collected by financial institutions, was followed by the Organisation for Economic Cooperation and Development's (OECD) introduction of the Common Reporting Standard (CRS). The recent media attention on offshore banking customer account and tax-related documentation further emphasised financial institutions' need to monitor relationships and transactions for potential tax evasion and suspicious activity.

Financial institutions attempting to respond to these trends will need to enhance their onboarding ecosystems to ensure compliance with the convergence of emerging tax requirements, increasing AML/CFT and sanctions requirements. Regulatory and process enhancements are becoming paramount for any financial institution looking to remain compliant and reduce risk and cost, while minimising any negative impact to customer experience.

**Observation:** The convergence of the regulatory requirements associated with “customer onboarding” provides financial institutions an opportunity to dismantle existing silos and work on developing and eventually optimising one standardised set of customer onboarding processes and controls that addresses all regulatory requirements (e.g. AML/KYC, FATCA, CRS, etc.). This approach should reduce the organisation’s overall compliance cost with additional downstream efficiencies associated with compliance monitoring and regulatory/tax reporting and lead to a better customer experience.

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## In detail

### Background

Global tax transparency initiatives are trending towards alignment with KYC processes for customer identification purposes. This increases the need for financial institutions to be accountable for all information they collect - confirming that their customers’ representations are reasonable and may be relied upon. The new frontier of global tax transparency requires sustainable change management programs that are effective across people, processes, data, and technology to effectively promote compliance. For long term success, an organisation’s tax transparency functional areas and AML/KYC programs must work together to drive efficient solutions for both the financial institution and its customers.

By addressing both tax transparency and AML/KYC documentation requirements during customer onboarding, financial institutions could provide better customer experience and reduce the need for multiple outreach efforts.

### Customer onboarding ecosystem

Account opening has become more complicated as AML/KYC requirements and tax transparency needs have begun to overlap. In light of the regulatory trends, financial institutions should consider standardising account opening procedures to create a single point of entry for customer identification and verification. A common customer onboarding approach should be broad enough to accommodate tax and other regulatory requirements.

A common framework will benefit both financial institutions and their customers in a number of ways.

A common onboarding function can:

- Facilitate transparency and efficiency across the institution;
- Reduce operational and reputational risk caused by insufficient and, even more importantly, inconsistent information; and
- Create cost efficiencies by reducing the number of resources required at onboarding.

While a single point of entry creates a number of operational efficiencies, financial institutions will need to balance this “one stop shop” with the disparate documentation required by various countries and/or regulatory regimes.

Financial institutions may opt to utilise “alternative documentation” collected as part of the AML/KYC process (i.e. documents already on file or publicly available information) to satisfy FATCA and CRS documentation requirements.

Unfortunately, acceptable alternative documentation may not be consistent in all cases, with specific acceptable documents likely to vary by country.

An armed forces identity card is sufficient to document an individual’s residency in the United Kingdom for tax purposes, but such a document may not be acceptable in other jurisdictions and further may not satisfy AML/KYC requirements.

The situation might be further complicated as the definition of tax residency is country specific and can be determined by other factors like number of days in a particular country and not solely by nationality. Such disparity in requirements creates a challenge for financial institutions with a global footprint that are looking to create a consistent approach to compliance.

**Observation:** Financial institutions should review, evaluate, and update their existing customer onboarding ecosystems to become a “one stop shop” that is flexible enough to accommodate distinct customer identification requirements across jurisdictions and address potential regulatory changes. This streamlined approach will enhance the customer experience while also creating internal efficiencies from a cost and regulatory perspective.

### Verifying customer identity

Another challenge in aligning the tax transparency regimes with the AML/KYC processes involves the recognition of divergent definitions across regulatory regimes and jurisdictions. Financial institutions must understand and adhere to variances in the applicable regulatory regime or jurisdiction to identify and verify the beneficial owner of an account. In addition to initial customer identification requirements, the tax and AML regulatory landscapes include a focus on verifying not only the identity of the entity that owns an account, but the identity of natural persons who own or control the entity.

While FATCA introduced the concept of “substantial US owner,” CRS broadened that approach to require information on any controlling person (who in some cases has no financial interest in the entity). In contrast, from an AML/KYC perspective, MAS requires financial institutions to identify and take reasonable measures to verify the identities of the “beneficial owner(s)” in relation to a customer. These definitions often will not align across different countries and/or regulatory regimes.

Beyond the initial onboarding of a customer, the regulatory verification process requires financial institutions to periodically refresh customer information on file and to resolve any conflicting information in a customer’s profile. Aligning functions such as tax operations with AML/KYC should streamline the due diligence process so that any notification of changes is processed in a way that streamlines any request for additional documentation. Financial institutions should work to build a system that enables cross-functional visibility in information gathering as well as subsequent maintenance activities.

As part of customer verification and ongoing account maintenance, regimes such as FATCA and CRS stipulate that financial institutions monitor changes in the customer’s profile that may affect the customer’s status. For example, a change in circumstance for tax purposes (e.g., a change in the mailing address of an individual account holder) may be identified based on direct communication with the customer or an alternative operational channel.

Operational risk arises where a change is identified in one part of the business (e.g., AML/KYC or other functional areas), but not communicated to other parts of the business (e.g., tax operations) for action.

A fragmented approach to customer onboarding and maintenance increases the risk that a change in circumstance will not be communicated between the various business units.

**Observation:** *To the extent data is not maintained centrally and accessible to all impacted units, financial institutions should foster a strategic alignment between Tax, Operations, and other internal functions to establish clear lines of ownership, communication and data/document sharing the groups. Data and documentation sharing also will need to consider compliance with other local data privacy laws and regulations.*

#### **Global trend in regulatory oversight**

Multiple regulators have identified the overlap between AML/KYC and tax transparency requirements and acknowledged that non-compliance in one area of an organisation may be seen as indicative of broader systemic non-compliance issues. Financial institutions evaluating their global risk compliance programs need to consider the consistency and interdependence of data across all regulatory regimes. MAS designated tax crimes as money laundering predicate offences in Singapore and financial institutions are expected to develop, implement and enforce internal policies, controls and procedures that effectively detect and deter the laundering of proceeds from wilful or fraudulent tax evasion through the financial system.

Financial institutions must develop a strong risk-based approach towards compliance to prepare for a broad range of regulatory inquiry. The global community, through the Financial Action Task Force (FATF), maintains guidance on the key elements of a robust AML/CFT framework.

See *The International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation* (FATF Recommendations). While not binding, the FATF Recommendations provide a minimum standard that all regulatory regimes should meet.

The regulator’s approach can vary for each regulatory requirement. For example, some regulators are looking for a formalised, sustainable, and risk-based approach to compliance (AML/CFT) while other regulators are focused at transaction level compliance (FATCA withholding). As part of this approach, regulators expect functional areas within a financial institution to communicate and work with each other. As a result, the onus is on financial institutions to coordinate their AML/KYC and tax programs in order to minimise the risk of non-compliance across the enterprise.

Furthermore, a more substantive approach to alignment is dependent on a governance model and integrated controls framework that ensure adherence to all regulatory requirements. Financial institutions seeking to build a strong controls framework, in alignment with regulatory expectations or new requirements, should begin by defining and understanding the risks resulting in non-compliance and evaluating existing processes and controls to determine if there are any gaps or conflicts in the required regulatory coverage.

**Observation:** *A strong governance framework is essential to meeting the ever increasing regulatory demands and promoting quality and control of customer data. The governance structure should include mechanisms to facilitate cross-functional collaboration and should evidence the safeguards and controls used to satisfy any potential regulatory inquiry.*

### **Cost effective compliance**

Financial institutions are caught between ever increasing compliance expectations and finding experienced resources and budget in a challenging business environment. Organisations must identify and assess operational and technology enhancements that improve their cost profile, yet maintain compliance. Those organisations that succeed in improving client onboarding are better positioned to increase customer retention and improve profits. Financial institutions should evaluate options available to them, for example, by (1) focusing on operational process alignment and optimisation, or (2) looking at emerging technologies that could result in sweeping changes in how customer onboarding is performed.

At a minimum, financial institutions should benefit by taking a close look at client onboarding functions and determine where AML/KYC and tax centric functions can be further aligned and optimised.

Redundancies in processes or data usage frequently exist and wringing out inefficiencies can yield tangible benefits. The use of business process management tools can improve control and reduce risk through the use of standard functions and templates. Both client facing and operations personnel roles and responsibilities should be evaluated to determine where improvements can be realised. Training and educational programs can fill skill gaps and bridge the divide between AML/KYC and tax operations (e.g. prepare people to better understand and implement new regulatory requirements for tax transparency regimes).

Leading organisations are assessing how emerging technology can radically change operational processes and benefit both the firm and the customer. “Digital labour” is not theoretical, nor is it new. Financial institutions are reducing costs, improving quality, and supporting scalability by using robotic process automation (RPA) for repetitive, business rule driven work.

In the context of customer onboarding and its myriad of compliance requirements, RPA can break down operational silos, improve operational efficiency (think “smart” tax form validation), and allow employees to perform more value added and customer focused activities.

### ***The takeaway***

As the rapid progression of tax transparency and regulatory requirements continues and these rules begin to migrate to other financial sectors, such as asset management, insurance, and alternatives, now is the time for organisations to “connect the dots” and develop a target operating model that establishes long term efficiencies and features a compliance program that converges both the AML/KYC and tax transparency requirements. Financial services firms that capitalise on these goals can build standardised yet flexible compliance environment, minimising the risk of non-compliance and ultimately enhance the customer experience.

### ***Let’s talk***

For a deeper discussion of how this development might affect your business, please contact:

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