FATCA – The Foreign Account Tax Compliance Act

July 2012
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<td>3</td>
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</tbody>
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What You Need to Take Away From This Session

Increase your understanding of FATCA regulation and policy changes.

- The principles of FATCA
  - The four pillars of FATCA
    - Classification
    - Due Diligence
    - Withholding
    - Reporting
  - Who is impacted?
1. Classification
Objective of FATCA

- FATCA’s objective is to uncover US tax evaders who invest directly in off-shore accounts or indirectly through ownership of foreign entities.

- To reach this goal, FATCA will require foreign financial institutions (FFIs) to provide information to the IRS on US accounts. In addition, passive non-financial foreign entities (NFFEs) will be required to provide information on substantial US owners to withholding agents.

- To enforce compliance, a 30% withholding tax will be imposed on certain payments made to FFIs and NFFEs that fail to make the required disclosures.
Foreign Financial Institutions (FFIs)

- An FFI is any non-US entity (i.e. created or organised outside the US) that falls into one of the following categories:
  - Accepts deposits in the ordinary course of a banking or similar business (e.g. a bank)
  - Holds, as a substantial part of its business, financial assets for the account of others (e.g. a custodian)
  - Is engaged, or holds itself out as being engaged, in the business of investing, reinvesting, or trading in financial instruments, including derivative contracts (e.g. mutual funds, hedge funds, private equity funds)
  - An insurance company that issues annuities or cash value insurance policies
  - **Observation**: This definition is very broad and covers types entities that are not traditionally considered financial institutions

- An FFI will suffer a 30% withholding tax on certain types of payments, unless it enters into an agreement with the IRS to perform certain due diligence, withholding and reporting obligations:
  - Participating FFI – An FFI choosing to enter into an FFI agreement with IRS and exempt from FATCA withholding
  - Non-participating FFI – An FFI choosing not to enter into an FFI agreement with IRS and subject to FATCA withholding
  - **Observation**: The Qualified Intermediary (QI) agreement will be amended to require a QI to agree to become a PFFI and meet the obligations set forth in the FFI agreement
Types of Compliant FFIs

- “Participating” FFI – Enters into an FFI Agreement with IRS
  - Registration period starts 1 January 2013
  - FFI Agreements first become effective 1 July 2013

- “Deemed compliant” Registered FFI
  - Must register with IRS along with the rest of the expanded affiliated group of FFIs
    - “Local” FFI
    - Non-reporting member
    - Qualified collective investment vehicle
    - Restricted fund

- Deemed Compliant Certified FFI
  - May self-certify their status on a Form W-8 without registering with the IRS
    - Non-registering local bank
    - Retirement fund
    - Non-profit organisation
    - FFI with only low-value accounts

- Owner-documented FFI – Withholding agent does the reporting

- Excepted FFI (e.g. Foreign governments) – Not subject to withholding
**FFI Agreements**

- FFI Agreements are effective on or after 1 July 2013
- PFFI must adopt written policies and procedures regarding due diligence processes
- PFFI must conduct periodic internal reviews of its compliance with these policies and procedures and its FATCA obligations
- **Observation:** US tax authorities will not require mandatory external audits of PFFIs

<table>
<thead>
<tr>
<th>Within 1 Year of FFI Agreement</th>
<th>Within 2 Years of FFI Agreement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Complete review of all high-value accounts, including the relationship manager query</td>
<td>Complete review of individual accounts not previously identified as US accounts and obtain necessary documentation</td>
</tr>
<tr>
<td>Perform the requisite review and obtain documentation for all prima facie FFIs</td>
<td>Complete review of pre-existing entity accounts not previously identified as a prima facie FFIs</td>
</tr>
<tr>
<td>- Form W-8IMY on file indicates FE is a QI or NQI</td>
<td></td>
</tr>
<tr>
<td>Complete a responsible officer certification stating</td>
<td>Complete a responsible officer certification stating</td>
</tr>
<tr>
<td>- Review of all high-value individual accounts is complete</td>
<td>- PFFI has completed the account identification procedures and documentation requirements for all financial accounts that are pre-existing obligations, or if not, that it treats the accounts in accordance with the requirements as outlined in the FFI Agreement</td>
</tr>
<tr>
<td>- There were no formal or informal procedures in place from 6 August 2011, on to assist account holders in avoidance of Chapter 4 provisions</td>
<td></td>
</tr>
</tbody>
</table>
Withholding Agents

- A withholding agent is any person, US or foreign, that has control, receipt or custody of a Withholdable Payment

- Withholding agents are required to
  1. Classify the payees by collecting and verifying documentation under due diligence rules prescribed by the IRS
  2. Withhold on Withholdable Payments where documentation is missing, invalid or insufficient
  3. File information returns with the IRS

- **Withholding**: 30% FATCA withholding can apply to
  - A Non-participating FFI ("NPFFI")
  - An NFFE that fails to identify its “substantial US owners, unless an exception applies;”
    - Exceptions are provided for NFFE’s deemed to represent a low risk of US tax evasion (e.g. publicly traded companies or affiliates of publicly traded companies, foreign governments, and active trades or businesses)
  - A “Recalcitrant” account holder of a participating FFI (“PFFI”)
    - Any person refusing to supply identifying information relevant to their FATCA status; or
    - Any identified US person that does not waive any local legal restrictions on reporting relevant information to the IRS
  - USFIs are not required to treat undocumented individuals as recalcitrant under FATCA because 28% backup withholding applies instead
2. Due Diligence

FATCA Compliance and Impact
Critical Distinction

- USFIs and PFFIs must adopt written policies and procedures regarding due diligence processes for both pre-existing and new accounts
  - For USFIs, new account procedures should be in place by 1/1/2013
  - For PFFIs, new account procedures should be in place by 7/1/2013 or later effective date of the FFI agreement

- For off-shore accounts and pre-existing accounts, the rules try to minimise the amount of ‘new’ information and documentation that will be needed from account holders, relying instead on information and documentation previously provided (for e.g. under local AML / KYC rules)

- In some cases, financial institutions will need to collect additional information and documentation to make the necessary FATCA classifications

- USFIs and PFFIs must review customer information for indicia, or indicators, of US status and request documentation from an account holder if one or more indicia of US ownership are found
## Account Distinctions

### Direct US Accounts
- A direct account maintained by an account holder that is a “specified” US Person

### Indirect US Accounts
- An account held by a US owned non-financial foreign entity is a US account
  - Whether held at an FFI or a USFI

- A US owned NFFE is a passive foreign entity that has one or more substantial US owners

### Excepted US persons
- Publicly traded corporations or affiliates
- Tax-exempt organisations and IRAs
- Federal, state or local government or an instrumentality
- Banks, dealers in securities, commodities or derivatives
- Real Estate Investment Trusts (REITs)
- Regulated Investment Companies (RICs)
- Common trust funds and charitable trusts

### “Substantial” ownership means
- More than 10% of a corporation’s stock, a profit or capital interest in a partnership or a beneficial interest in a foreign trust
- Any portion of a foreign trust that is classified as a grantor trust and is taxable to a US grantor

### In contrast, most know your customer ("KYC") regimes require identification of owners of a minimum of a 25% interest in privately held entities
Account Distinctions (Cont’d)

Off-shore vs. On-shore Obligations

- Off-shore Obligation
  - Any account, instrument, or contract maintained and executed at an office or branch of the withholding agent at any location outside of the US
  - For any payment made or sale effected outside of the US with respect to an off-shore obligation
  - USFIs and FFIs can rely on documentary evidence or written statements to establish foreign status
  - If there are any US indicia, additional documentation must be obtained to substantiate foreign status
  - Form W-9 must be used to establish US status

- On-shore obligations
  - Forms W-8 must be collected to establish foreign status
  - If there are any US indicia, additional documentation must be collected to substantiate claims of foreign status

Individual vs. Entity Account

- Entity – Anyone other than a natural person. Includes corporations, partnerships, trusts, estates

- Financial Institutions
  - USFIs
  - FFIs – Participating, Non-Participating, Deemed Compliant, Excepted, Owner Documented, Territory Organised

- Non-Financial Entities
  - Non-financial US entity
  - Non-financial foreign entity (NFFE) – Active, Passive, Excepted, Territory Organised

- Individuals
  - US Person
    - Foreign Person
    - Recalcitrant
Account Distinctions (Cont’d)

Pre-existing Obligations

- USFIs – Pre-existing obligations are accounts opened or contracts entered into prior to January 2013
  - USFIs must determine the FATCA status of all pre-existing entity accounts
    - However, no due diligence is prescribed for accounts held by individuals at a USFI
  - Transition rule for 2014 – A withholding agent must withhold on withholdable payments made to pre-existing accounts in 2014 only if the payee is
    - A Prima Facie FFI
    - But is not a PFFI, a DCFFI or an exempt beneficial owner
  - USFIs must complete due diligence on other entity accounts by 1/1/2015

- PFFIs – pre-existing obligations are accounts opened or contracts entered into prior to FFI Agreement effective date (no earlier than 7/1/2013)
  - For individual accounts, a PFFI must document any pre-existing account that has certain US indicia

Pre-existing Obligations

- Transition rule for 2014 – same as for USFIs
- Unless a PFFI elects otherwise, it is not required to document a pre-existing account if
  - No account holder has previously been documented as a specified US Person, and
  - The aggregate balance or value of the account and any related accounts is US$50,000 or less for individuals or US$250,000 or less for entities

New Obligations

- Obligation will include any account, instrument, or contract maintained or executed by the withholding agent
- USFIs – accounts opened 1 January 2013 or later
- FFIs – accounts opened prior to FFI Agreement effective date, which will be no earlier than 1 July 2013
- Both USFIs and FFIs must obtain sufficient documentation to identify and classify the payee/account holder
Pre-existing Off-shore Accounts at PFFIs

- Individual accounts >US$1 million (as aggregated) subject to “enhanced review,” which must be completed within one year
  - Enhanced due diligence means review of all AML / KYC documentation for the account and related accounts and includes an inquiry of a relationship manager

- All other individual accounts subject to an electronic search for indicia of US status within two years
  - If indicia found, account must be documented essentially as if it were a new account
  - If no indicia found, can treat the account as “not a US account"
  - Pre-existing individual accounts are retested at the end of each subsequent year for >US$1 million status; if so, enhanced review required

- Pre-existing entity accounts that are not classified as prima facie FFIs must be documented essentially as if they were new accounts within two years
# Summary of Due Diligence for Pre-existing Accounts at a PFFI

## Pre-existing Account Remediation

<table>
<thead>
<tr>
<th>Account Type</th>
<th>Exempted</th>
<th>Completed Within Two years of FFI Registration</th>
<th>Completed Within One year of FFI Registration</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individuals</td>
<td>US$50,000 or Less</td>
<td>US$50,000–1,000,000</td>
<td>High Value &gt;US$1,000,000</td>
</tr>
<tr>
<td></td>
<td>Exempted</td>
<td>Electronic Search for US Indicia</td>
<td>Electronic Search for US Indicia</td>
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<tr>
<td></td>
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<td></td>
<td>Manual Search as Required</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Relationship Manager Query</td>
</tr>
<tr>
<td>Entities</td>
<td>US$250,000 or Less</td>
<td>&gt; US$250,000</td>
<td>Prima Facie FFIs</td>
</tr>
<tr>
<td></td>
<td>Exempted</td>
<td>Review AML / KYC documentation</td>
<td>Review AML / KYC documentation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Document FATCA Status</td>
<td>Document FATCA Status</td>
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</tbody>
</table>
US Indicia of Individual Accounts at a PFFI

- PFFIs must review customer information for *indicia*, or indicators, of US status and request documentation from an account holder if one or more indicia of US status are found.

- An individual account holder is treated as having US *indicia* if the account includes any of the following:
  - Identification of account holder as US citizen or resident
  - US place of birth (new for 2013)
  - US resident or mailing address
  - US telephone number (new for 2013)
  - Standing instructions to transfer funds to a US based account
  - Power of attorney or signatory authority granted to person with US address; or
  - In care-of or hold mail address that is sole address of account holder
3. Withholding Payments

FATCA Compliance and Impact
## What is a Withholdable Payment?

<table>
<thead>
<tr>
<th>On or After 1 January 2014</th>
<th>On or After 1 January 2015</th>
<th>On or After 1 January 2017 at Earliest</th>
</tr>
</thead>
</table>
| • US source FDAP income (interest, dividends, royalties, etc.)                           | • ADD gross proceeds (plus accrued interest) from sale / redemption of securities that produce, or could produce, US source interest or dividends | • Foreign passthru payments paid by PFFIs  
  – Not defined in proposed regulations                                                      |
|                                                                                         | • Examples: Stock or debt issued by a US corporation or the US government                 |                                                                                                      |
| • Interest paid on a deposit at a US branch of any bank or a non-US branch of a US bank  | • Continue withholding on US source FDAP income, interest on deposits held at a US branch of any bank or a non-US branch of a US bank, and dividend equivalent payments |                                                                                                      |
| • Includes interest paid by Citibank NA at its non-US branches                          |                                                                                         | • Continue withholding on US source FDAP income, interest on deposits held at a US branch of any bank or a non-US branch of a US bank, dividend equivalent payments and gross proceeds from US securities |
| • Dividend equivalent payments                                                          |                                                                                         |                                                                                                      |
|   – Substitute dividends paid under a securities loan or repo of a US equity             |                                                                                         |                                                                                                      |
|   – Payments under a swap pegged to dividends on a US equity                             |                                                                                         |                                                                                                      |
Special Rules on FATCA Withholding

- Exceptions from FATCA Withholding
  - Short-term interest / OID
    - Debt with an original term of 183 days or less
    - Excludes commercial paper, repos, T-bills
  - Income effectively connected with the conduct of a trade or business in the US (ECI)
  - Sales of fractional shares that would be excluded from Form 1099-B reporting (<US$20)
  - “Ordinary course of business” payments for non-financial services, goods and use of property
    - Bank and brokerage fees not excepted
  - Pure introducing broker activities, where no payments are made, are not subject to FATCA

- Sale Transactions Effected with Multiple Brokers
  - Where multiple brokers are involved in effecting a sale
    - Each broker must determine whether to withhold based on the status of its payee
  - In a Delivery vs. Payment (DVP) or Cash on Delivery (COD) transaction, each broker that pays gross proceeds is a withholding agent
    - Payee is the clearing organisation or the custodial bank that receives the gross proceeds
    - Withholding creates the possibility of failed sales that will result in severe market disruption
Grandfathered Obligations

• Payments on obligations outstanding on 1 January 2013

• An FI will need to track grandfathered obligations and material modifications on its security data base, loans and contractual obligations

• Grandfathered obligations do not include
  – An instrument treated as an equity for US tax purposes
  – An agreement that lacks a definitive expiration or term (e.g. savings deposits, demand deposits)
  – A brokerage, custodial or similar agreement to hold financial assets for others and collect income
  – A master agreement that merely sets forth standard terms and not the specific terms of a particular transaction

• Examples of affected obligations
  – Debt obligations issued by US corporations, the US government or its agencies
  – A binding agreement to extend credit for a fixed term (e.g. line of credit or revolving credit facility)
  – Repos where the collateral seller is a US legal entity
  – A derivatives transaction entered into under an ISDA Master agreement and evidenced by a confirmation
Possible Modified Obligations

• How to identify material modifications
  – Significant amendment of terms of debt obligation
  – Large consent payments made to holders of loans or debt securities in exchange for acceptance of new terms of debt
  – Rely on public documents for federal tax treatment of public debt
  – Rely on loan modification documents for privately placed obligations

• Repo roll-overs – Unless is continuation of same debt

• Taxable reorganisation – An exchange of old debt obligations for new debt obligation
Who Is Subject to Withholding?

**USFIs**
- No FATCA obligation to withhold on individuals
- Payments of US source FDAP income to documented US persons
  - Generally no withholding
  - 28% backup withholding if
    - No TIN
    - Notification of Name / TIN mismatch
    - Notification by IRS that payee underreported dividend or interest income
- Payments of US source FDAP income to non-US individuals
  - Withholding at 30% under Chapter 3, unless reduced by treaty
- USFIs must withhold on withholdable payments made to
  - Non-participating FFIs (including limited branches and affiliates, and prima facie FFIs)
  - Electing participating FFIs (including non-withholding QIs)
  - Non-compliant NFFEs

**PFFIs**
- PFFIs must withhold 30% on payments to
  - Non-participating FFIs
  - Includes limited branches and affiliates
  - This may mean withholding on payments made to certain Citi subsidiaries
- Prima facie FFIs (generally QIs and NQIs not affirmatively documenting PFFI status)
- Electing participating FFIs
- Non-compliant NFFEs
- Recalcitrant accounts (undocumented individuals)
Withholding Practicalities

- FATCA withholding is 30%
- FATCA withholding cannot be reduced by either statute or treaty
- Generally speaking, if there is FATCA withholding, then there would not be any US non-resident withholding (Chapter 3) or backup withholding (Chapter 61)
  - If there is an NQI that is a PFFI and some of the underlying account holders are documented for FATCA purposes and others are not, those who are not properly documented for FATCA purposes would be withheld at 30% while the other account holders may be subject to a different rate
## Withholding Timeline

<table>
<thead>
<tr>
<th>Types of Payments Subject to Withholding</th>
<th>Tax Year</th>
<th>First Reporting Date</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Fixed, Determinable, Annual or Periodic (FDAP) Income from US sources</strong></td>
<td>2014</td>
<td>2015</td>
</tr>
<tr>
<td>• Dividends</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Interest</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Other US Source Income</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Gross proceeds from US securities</strong></td>
<td>2015</td>
<td>2016</td>
</tr>
<tr>
<td>• Sales or Redemptions of Stock, Mutual Fund Shares, Debt Obligations, or Other Securities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Capital Gain Distributions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Return of Capital Distributions</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Foreign “Passthru” Payments</strong></td>
<td>After 1 January 2017</td>
<td>TBD</td>
</tr>
<tr>
<td>• Allocable Amount of US Source Income Distributed to Non-participating FFIs or Recalcitrant Accounts</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
4. Reporting

FATCA Compliance and Impact
# Information Reporting By USFIs

<table>
<thead>
<tr>
<th>Payee Type</th>
<th>Report What</th>
<th>Form Type</th>
<th>1st Tax Year</th>
<th>IRS Due Date</th>
<th>Authority</th>
</tr>
</thead>
</table>
| US Non-exempt Recipient            | • Name, TIN and address of non-exempt recipient  
• Aggregate amount for each income type, or  
• Separate amount for each position (OID or gross proceeds)                                                                                                         | 1099      | 2013         | March 31 (Electronic Filing) | IRC §§6041, 6042, 6045 and 6049                |
| Owner-documented FFI                | • Name of FFI to which a Chapter 4 reportable amount is paid  
• Name, TIN, address of each specified US person that has a direct or indirect interest in the FFI                                                                                           | TBD       | 2014         | TBD                   | §1.1474-1(i)(1)                                 |
| Substantial US Owners of an NFFE   | • Name of NFFE  
• Name, TIN, address of each substantial US owner (unless excepted)                                                                                                                                       | TBD       | 2014?        | March 15              | §1.1472-1(e)(2)                                 |
| Foreign Recipient                  | • Name, address, and TIN  
• Aggregate reportable amount for each income type  
• US tax withheld, if any                                                                                                                                                    | 1042-S    | 2014         | March 15              | §1.1474-1(d)                                   |
Reporting by PFFIs on US Accounts

- Phased-in reporting on US accounts
- For 2013 report US accounts identified as of 6/30/2014
- For tax year 2013 and 2014 – Report for each account holder
  - Name / address / TIN of each specified US account holder
  - Name / address / TIN (if any) of NFFE account holder and name / address / TIN of each substantial US owner of the NFFE
  - Account number
  - Account balance / value at year-end or closing date
- For 2015 – Report same as for prior years, plus
  - Gross US and foreign source income
- For 2016 – Report same as for 2015, plus
  - Gross proceeds from sale / redemption of property
- Due date 31 March
  - Except reporting for 2013 due 9/30/2014

Due date 31 March
- Except reporting for 2013 due 9/30/2014
US Payors that are PFFIs

- US payors (other than US branches) that are PFFIs (e.g. US controlled foreign corporations)
- Must meet the same reporting requirements as PFFIs that are not US payors, but
- US payors that report US non-exempt recipients on Form 1099 as required satisfy the Chapter 4 reporting requirements on such US accounts
- US payors with established 1099 reporting systems may wish to elect to report US accounts on Forms 1099 to satisfy Chapter 4
  - Would apply to accounts held by
    - Specified US persons who are exempt recipients, and
    - NFFEs who are exempt foreign persons but have substantial US owners
- If US payor reports on Form 1099, it must also report the account number and the identity of an account holder that is an NFFE
Reporting by PFFIs on Recalcitrant Accounts

- PFFI must report separately the aggregate number and total value of recalcitrant accounts in each of the following categories:
  - Recalcitrant accounts that have US indicia
  - Recalcitrant accounts that lack US indicia
  - Recalcitrant accounts that are dormant

- Due dates:
  - For 2013 – due 9/30/2014
  - For 2014 and later – due 3/31 of following year

- Form type to be determined
Form 1042-S Recipients

- All withholding agents must report on Form 1042-S to the following types of recipients
  - PFFI or DCFFI, even if acting as an intermediary
  - NPFFI that is a beneficial owner
  - A PFFI account holder if the PFFI does not have withholding responsibility
  - An NFFI that is not a flow-thru entity
  - Partner, owner or beneficiary of a flow-thru entity that is a NFFE when treated as a beneficial owner
  - An exempt beneficial owner
  - QI that is a foreign branch of a US person
  - Limited branch of a PFFI
Amounts Reportable on Form 1042-S

- Reportable amounts by all withholding agents
  - US source FDAP income paid after 12/30/2013 whether or not subject to withholding
  - Gross proceeds from the sale or redemption of US securities that are subject to withholding after 2014
  - Foreign passthru payments subject to withholding after 2016

- For 2015 and 2016, PFFIs must report foreign source income paid to NPFFIs on Form 1042-S
  - IRS may use this information to project the amount of pass-through payments that could be subject to withholding after 2016
## FATCA Reporting Timeline

<table>
<thead>
<tr>
<th>Type</th>
<th>Tax Year</th>
<th>First Reporting Due Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recalcitrant Account Reporting (With US Indicia, Without US Indicia, and Dormant)</td>
<td>2013</td>
<td>30 September 2014</td>
</tr>
<tr>
<td>US Accounts (Name, Address, Account Number, Account Balance or Value)</td>
<td>2013 and 2014</td>
<td>2014 and 2015</td>
</tr>
<tr>
<td>Income for US Accounts Must Also be Reported</td>
<td>2015</td>
<td>2016</td>
</tr>
<tr>
<td>Full Reporting for US Accounts, Including Gross Proceeds from Sales of securities</td>
<td>2016</td>
<td>2017</td>
</tr>
</tbody>
</table>

- May elect to report all amounts paid to US persons as if the PFFI were a US payor, except that information for US exempt recipients must also be reported
- Incremental reporting of substantial US owners of non-US entities, including the name of the entity and US owner details
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efficiency, renewable energy & mitigation