

# IIAC LETTER

## An examination of today's AML/ATF regime in Canada

### INTRODUCTION

Over the last decade, the IIAC has engaged in extensive consultation with the Department of Finance, FINTRAC and industry stakeholders to promote effective and practical anti-money laundering ("AML") and anti-terrorist financing ("ATF") requirements, minimize the cost burden and risk to investment dealers, and safeguard the competitiveness of our markets. A robust, efficient and effective anti-money laundering/anti-terrorist financing regulatory Regime acts to detect and deter criminal activities and to enhance the overall credibility of our Canadian capital markets. The IIAC supports the importance of maintaining the integrity of this Regime in Canada.

### THE PACE OF REGULATORY CHANGE

In July 2019, the Department of Finance published the final version of the proposed regulatory amendments to the *Proceeds of Crime (Money Laundering) and Terrorist Financing Regulations* ("PCMLTFR"). The stated objectives of the new Regulations are to (a) modernize the existing AML/ATF Regime, (b) close loopholes in Canada's AML/ATF Regime, and (c) address a number of deficiencies outlined by the Financial Action Task Force ("FATF").

These new Regulations are a set of regulatory amendments that bring changes to all regulations and schedules. This package is the final element of the 2012 Parliamentary Review of the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* ("PCMLTFA") and is necessary to implement outstanding legislative changes made in 2014 and 2017.

Since the last review, a number of legislative and regulatory amendments have been made to enhance Canada's legislative framework and further its mandate of deterring and detecting money laundering and terrorist financing activities. Some of these amendments have also improved Canada's compliance with the international standards set out by FATF.

This rapid pace of legislative and regulatory changes to the AML Regime saw numerous discussion papers and proposed regulatory amendments over the last number of years. The IIAC participated throughout all steps of stakeholder engagement and submitted many issues and comments throughout the process that saw the government incorporate further amendments to improve efficiencies, address specific drafting comments and provide opportunities to reduce the regulatory burden.

The new Regulations contain significant changes to Canada's anti-money laundering regime. Consequently, our members will need to make numerous changes to their current practices and procedures in order to ensure that they remain in compliance with the Act and its Regulations.

Some changes have already come into effect, with the majority of regulatory amendments having an implementation date of June 1, 2021. Beyond 2021, we expect to see FINTRAC make amendments to the form and manner of required reports, and FINTRAC has committed to deliver on report design efficiencies.

## CLIENT IDENTIFICATION AND TECHNOLOGY

The most welcome and positive change to the PCMLTFR is the movement towards a more forward-thinking and innovative approach to digital documentation and identification methods. This change was advocated for by the IIAC in previous consultations with the Department of Finance. The PCMLTFR repealed the previous client identification requirement that prohibited the use of scanned or photocopied documents. It also introduced the use of digital identification methods, including facial recognition.

These changes are meant to modernize identification measures and have been described by FINTRAC as "burden-relieving for reporting entities and facilitates customer on-boarding in an online environment as reporting entities would be able to use scans, photocopies, and electronic means of verifying identification." As these technologies become more and more commonplace and as firms adapt to this new technology, FINTRAC will now be ready to accept these methods going forward.

However, as seen during the pandemic, firms were anxious to use government-issued photo identification as a standalone method, although FINTRAC originally maintained that firms needed the necessary technology for proper authentication of documents presented. Thankfully, after a request by the IIAC, FINTRAC recently relaxed its requirement that firms have software or technology to authenticate client identification and instead, firms can rely on human judgement for authentication. This is only a temporary measure, effective as long as health authorities require physical distancing. Given this recent experience, it is likely firms will move quickly to have this technology in place, in order to undertake proper identification in non-face-to-face settings.

The pace of future developments in digital identification will change how the industry addresses its verification of identity requirements under the Regime. At the forefront of considerations will be the need to contemplate the balance between privacy and security against convenience. The benefits of properly using these new tools will include a reduction in risk, a cost reduction for firms in the time to collect and review paper documents, and creating an ease for customers in an online platform.

Developments in this area are now occurring and we will see rapid improvements in the use of digital identification in a short time frame. These include the Digital Identification and Authentication Council of Canada's ("DIACC") Pan Canadian Trust Framework, a non-profit coalition of public and private sector leaders collaborating on defining the Canadian digital identity ecosystem. DIACC has just released a helpful self-assessment directory that is intended to help reporting entities in their assessment of products that assess identification documents and verify identity. Furthermore, there are numerous identity networks that have now launched or are in development. Going forward, there will also have to be considerations regarding the future interconnectedness with open banking that will be coming over the next number of years.

## WINS ACHIEVED AND CHALLENGES AHEAD

These new Regulations also include additional changes based on industry feedback that identified potential operational and implementation challenges. These include:

- the removal of the requirement to keep a record of unsuccessful reasonable measures taken when meeting certain obligations;
- that the provisions in regard to “frequent and extensive” ongoing monitoring of high-risk accounts be removed from the proposed Regulations;
- the removal of a proposed provision which required a securities dealer that does not verify identity in the context of a suspicious transaction report because of concerns of “tipping off”, to keep a record of the reasons for their belief that doing so would inform the person that the transaction would be reported;
- the removal of the clause relating to “every other detail that identifies the transaction”.

Despite these positive changes, an area of continued concern in the new Regulations relates to the changing of timing related to STRs to report “as soon as practicable”. The IIAC is concerned that this term is highly subjective and it is unclear how FINTRAC will interpret this in the course of its examination of firms.

Also coming into effect next year is the revised IIROC AML Guidance (the last revision was 10 years ago - a joint initiative by the IIAC and IIROC). The new Guidance includes updates to reflect the new regulations and FINTRAC guidance, as well as regulatory updates that include new changes to the client identification and verification requirements.

## BENEFICIAL OWNERSHIP

The IIAC has been advocating for a national registry on beneficial ownership for some time. Under the PCMLTFR, IIAC members are required to collect and confirm beneficial ownership information with respect to private corporations, trusts and partnerships. However, in the absence of a registry, many members are faced with the only option of obtaining a signed certification, attestation or statement from a person authorized to act on behalf of the client with respect to the beneficial ownership information. Furthermore, as required under the PCMLTFR, members retain a copy of the certification, attestation or statement to demonstrate that reasonable measures were taken to confirm the accuracy of the beneficial ownership obtained.

There is little official documentation to confirm the accuracy of beneficial information obtained. This puts the industry in a very difficult position since, in most cases, there is no other source of information beyond that obtained from the client that would allow members to confirm accuracy.

A national registry that contains current and accurate information with respect to beneficial ownership will not only reduce the burden on our members but also improve the accuracy and transparency with respect to beneficial ownership information.

As such, the IIAC applauded the consensus reached by federal and provincial/territorial finance ministers on December 11, 2017 to enhance the transparency and improve access to beneficial ownership information, and the reaffirmation of this commitment in June 2019. While we recognize that finance ministers have committed to changes to provincial statutes that are intended to make

information on beneficial ownership available to law enforcement, tax and other authorities, the IIAC strongly believes that this information should also be made accessible to financial services firms, including securities dealers, that have obligations under the PCMLTFA and are mandated to collect and confirm beneficial ownership information (as well as take measures to keep such information up-to-date) on the entities with which they do business.

The IIAC has continually advocated the need for a national beneficial ownership registry and to that end, we have previously provided submissions to the Department of Finance and provincial governments, and provided testimony before the House of Commons Standing Committee on Finance.

We are pleased that the federal government as well as the government of B.C. are moving this initiative forward with their recently released consultation papers related to beneficial ownership transparency. The IIAC has commented on both these consultation papers, outlining our public support of the creation of a national registry for beneficial ownership, given our members' responsibility to collect beneficial ownership information for corporations, trusts and other entities and take reasonable measures to confirm the accuracy of the information collected, without always having reliable data to cross-check what is provided by clients.

The IIAC will continue to push this initiative forward as more provinces introduce the necessary corporate legislation to require the collection of beneficial ownership information that will ultimately lead to a national registry.

## NATIONAL INHERENT RISK ASSESSMENT ("NIRA")

The Government of Canada is currently conducting an update of the 2015 NIRA of ML/TF to ensure that its understanding of ML/TF risks remain accurate and that the Canada AML/ATF Regime continues to protect Canadians, the integrity of markets and the global financial system. As new ways to exploit the financial systems and legitimate business for criminal purposes develop, it is important for the Government to be continually renewing its risk assessments to identify money laundering and terrorist financing methods that are continually evolving.

The last assessment found that the money laundering threat was rated very high for corruption and bribery; counterfeiting and piracy; certain types of fraud; illicit drug trafficking; illicit tobacco smuggling and trafficking; and, third-party money laundering. Transnational organized crime groups and professional money launderers are the key money laundering threat actors in the Canadian context. However, despite these concerns, the terrorist financing threat in Canada was deemed not as pronounced as other regions in the world where weaker AML/ATF regimes can be found.

NIRA provides an overview of the risk of money laundering and terrorist financing, in terms of threats and vulnerabilities, before the application of any mitigation measures such as legislative, regulatory and operational actions that prevent, detect and disrupt money laundering and terrorist financing arise/can be implemented.

As part of this process, the Government is seeking private sector input and perspectives in relation to their respective sectors and on broader challenges related to ML/TF in Canada. This input will support Canada's evaluation of risks by complementing the information available to the Government on the various sectors, and by adding a perspective from entities directly on the front

line of the fight against ML/TF. The IIAC is participating in this exercise to ensure the government is adequately informed of potential ML/TF risks within our sector.

## ACCESS AND TRANSPARENCY

Over the last number of years, the IIAC has been pleased with the increased availability of FINTRAC to meet with the investment industry to respond to questions, explain internal processes and its willingness to consider options and alternatives for improvements. We are also pleased that FINTRAC has been seeking industry input as it develops its new guidance to reflect the new Regulations. FINTRAC has also worked well with the industry in recent years to increase their awareness and understanding of their compliance obligations under the PCMLTFA.

In our consultations with FINTRAC, we have expressed our desire for increased transparency and interaction with FINTRAC regarding suspicious transaction reports (“STRs”).

Improved clarity on the retention of STRs would be extremely beneficial for the industry. When reporting entities are not provided with feedback on the disposition of the original STR, they may continue to file additional suspicious transaction reports along similar themes if the activity continues, without the opportunity to more appropriately contextualize or suspend filing as the case may be.

We have also shared with FINTRAC that it would be helpful if it could provide information to reporting entities in situations where the entities do not meet the threshold for a suspicious transaction or where FINTRAC requires additional information to make a determination.

Without improved information sharing, reporting on these additional transactions exacerbates the privacy concern of parties referred to in the STR and requires additional resources for FINTRAC. It is also an inefficient use of resources for our members. The IIAC will continue to advocate on this initiative.

The IIAC is also an active participant on the Department of Finance’s Advisory Committee on Money Laundering and Terrorist Financing, which brings participants from various industries together, along with finance and FINTRAC, to discuss issues and receive updates on AML projects and initiatives.

## CONCLUSION

The industry is now under considerable pressure to align their compliance programs and processes to ensure that they will be able to meet new and rapidly changing regulatory expectations. Systems will need to be updated, and certain new ones put in place, to mirror these expectations. It is apparent however, that Canada’s AML/ATF regime is evolving and firms recognize the importance of executing these new requirements.

Technological changes will continue to drive how the industry responds to these regulatory expectations. These include developments related to virtual currencies, the introduction of fintech and regtech, and of course, digital identity recognition. Although these changes, of course, present new opportunities for money laundering and terrorist financing activities, they also allow the industry to reduce their own threats and risks while better serving clients and help to ensure they are meeting their obligations under the PCMLTFA.

On the horizon, it is clear that the Government remains committed to closing any remaining legislative and regulatory gaps identified in the report by the House of Commons Standing Committee on Finance as part of the last five-year statutory review of the PCMLTA, and has work underway to support Parliament's upcoming five-year review. The IIAC has participated in that process and recognizes the importance of developing a strong AML/ATF Regime that requires continual updates in order to be responsive to emerging risks and evolving standards.

The 2016 Mutual Evaluation report by FATF found that Canada has strong anti-money laundering and anti-terrorist financing legislation and regulations but noted there are several areas where action could be taken to ensure the framework meets technical standards and is even more effective.

The IIAC is committed to ensuring Canada makes these necessary improvements, which will result in the country being in a strong position to combat money laundering and terrorist financing going forward.

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