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AMENDMENTS TO CANADA'S ANTI-MONEY LAUNDERING LEGISLATION: WHAT'S NEW AND WHAT'S NEXT

7/6/2015

Financial Services Regulatory

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On July 4, 2015, the federal government released amended regulations (Regulations) under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (PCMLTFA).

While there are some additional regulatory burdens imposed on regulated entities in respect of domestic politically exposed persons (PEPs), and additional components to be considered in risk assessments, many of the proposed changes will be welcomed by regulated entities as they provide more principle-based regulation and less prescriptive requirements, especially in the context of verification of identity and electronic signatures. These amendments should allow regulated entities more flexibility in offering retail financial services online without the regulatory constraints that currently exist.

In addition to the amendments made to the general regulations, the Administrative and Monetary Penalties (AMPs) Regulations have also been revised to include compliance obligations that were previously unaddressed by these regulations. There have also been some amendments made to the Suspicious Transactions Reporting Regulations (STR Regulations).

MATERIAL AMENDMENTS

Identity Verification

One of the most challenging compliance obligations under the current Regulations are the prescriptive requirements setting out how regulated entities must verify identity, especially in the non-face-to-face context. Under the current regulatory scheme (except in the credit card context) it is difficult, if not impossible, for regulated entities to verify identity on a non-face-to-face basis (for example, online or over the phone) in real time. This has proven to be a frustrating experience, especially given the growth in online and mobile commerce since the original non-face-to-face verification methods in the Regulations introduced in 2008.

The proposed amendments now provide regulated entities with greater flexibility in how they carry out identity verification and are more e-commerce friendly. Interestingly, all of the current identity verification methods have been replaced by the new ones, even in the credit card context. The new permitted methods of identity verification include the following:

- Referring to an identification document containing a photograph (and a name) that is issued by a federal or provincial government (other than a municipal government) or by a foreign government, and by verifying that the name and photograph are those of that person. This requirement for a photograph is a new requirement; previously a regulated entity could rely on any government issued identification. This is clearly a more prudent approach to identity verification from a risk-based perspective. There is also an additional requirement to actually verify that the name and photograph are those of that person.
- Referring to information concerning the individual being identified on request from a federal or provincial government body that is authorized in Canada to ascertain the identity of persons, and by verifying that either the name and address or the name and date of birth contained in the information are those of the person whose identity is being verified.
- Referring to a person's Canadian credit file that has been in existence for at least three years and verifying that the name, address and date of birth contained in the credit file are those of the person whose identity is being verified. This provision is a welcome change as under the current Regulations, reference to a credit report without a secondary source, is not a compliant means of identity verification.
- Confirming that an affiliated entity (including a member of the same financial services cooperative or credit union central) that is regulated under the PCMLTFA or a non-Canadian entity that carries on a similar business outside of Canada has previously ascertained the person's identity in compliance with any of the permitted methods and by verifying that the name, address and date of birth contained in such entity's records are those of the person whose identity is being verified.
- By doing any **two** of the following:
    - Referring to information from a reliable source containing the name and address of the person being identified and verifying that the name and address are those of the person
    - Referring to information from a reliable source that contains the name and date of birth of the person being identified and verifying that the name and date of birth are those of the person
    - Referring to information that contains the name of the person being identified and confirming that the individual has a deposit account or credit card or other loan account with a Canadian financial entity and verifying that information

In utilizing this "two out of three" method of identity verification, the proposed Regulations require that the information that is referred to must be from different sources and that the person whose identity is being verified cannot be utilized as a source.

These provisions will allow for greater flexibility in performing identity verification and are welcome principle-based requirements. As a result of these changes, the use of a "reliable source" will now become the critical element of any identity verification. What is a "reliable source" will likely be a subject of exploration for many regulated entities, but the Impact Analysis Statement released with the Regulations indicates that this is a matter that Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) will be preparing guidance to address.

In respect of all identity verification methods outlined above, the proposed Regulations provide that where a document is used to ascertain identity under any of the above noted methods, it must be original, valid and current. Other information that is used (other than an identity document) must not include an electronic image of a document.

Other questions that arise from the foregoing methods include:

- What will be deemed to be a "reliable source"? This is one area that will likely be analyzed from many

angles by regulated entities. For example, is a hydro bill containing a name and address a "reliable source"? In that regard, it is reasonable to conclude that the current acceptable methods for non-face-to-face identification verification would be viewed as "reliable sources."

- What is meant by the requirement in many of the provisions to "verify" the information? Under the current Regulations, for face to face identity verification, the Regulations require a regulated entity to refer to an identity document. The proposed Regulations require regulated entities to take a further step to "verify that the name and photograph are of that person". Is there an implicit requirement to ask for another piece of identification to verify the information?

Another welcome change in the proposed Regulations is the ability of a regulated entity to rely on identity verification previously undertaken by another person, even if that person is not regulated under the PCMLTFA.

Under the current regime, in order to rely on another person to perform identity verification, a regulated entity is required to enter into a written arrangement for that purpose where the person agrees, as agent, to undertake the identity verification.

The proposed Regulations significantly expand the circumstances where a regulated entity can rely on actions taken by another in the identity verification context. Specifically, a regulated entity can now rely on measures that were previously undertaken by another person (acting independently) where that person verified the identity of a person, even if the person was doing so outside of the PCMLTFA context. In addition, if a person verified identity information for another regulated entity under a previous agency relationship, then a regulated entity can rely on that identity information as well. In all circumstances, a written arrangement needs to be in place where the regulated entity appoints the person as agent and all verification information must be obtained from the agent. In addition, the regulated entity must be satisfied that the information is valid and current and that the prescribed identity verification methods were complied with. These provisions will bring more certainty in the context of portfolio acquisitions by allowing purchasers of financial assets to rely on verification previously done by the vendor. It will also provide greater flexibility for identity verification in the day-to-day assignment of financial instruments and contracts.

The one uncertainty in these provisions is the requirement for the information to be "current" in order to be relied upon. In that regard, it is unclear what is intended by this provision. If identity was verified three years ago, is it current? What about one year ago? This is something that regulated entities should consider in providing commentary under the Regulations.

One of the more significant burdens under the current regulatory regime is the restriction on a regulated entity's ability to rely on previous identity verification undertaken by it in respect of its own customers in the online context. In that regard, the current Regulations only allow a regulated entity to rely on previous identity verification performed on an individual in those circumstances where the regulated entity "recognizes" the individual. FINTRAC has narrowly interpreted the term "recognize" to mean visual or voice recognition. As a result, it is impossible under the current regulatory regime to "recognize" a customer online. Thankfully, this provision has been modified so that a regulated entity is now permitted to rely on previous identity verification they performed provided that they do not have any doubts about the information.

The nature of the amendments made in respect of identity verification demonstrates that the government carefully took into consideration stakeholder feedback to produce a more practical and relevant regulatory approach to client identification in light of the rapid pace of technological change and the online world in which financial services are more frequently being offered. The identity verification provisions will come into force on the day on which the Regulations are registered.

Electronic Signatures

Another area under the current Regulations that has been historically difficult to comply with in the online world, is the requirement imposed on certain regulated entities to obtain a "signature card" when opening an account. A "signature card" is currently defined in the Regulations as "a record signed by a person who is authorized to give instructions in respect of an account."

Although the term "signature" includes an "electronic signature," FINTRAC has narrowly interpreted this provision to require an actual "wet" signature allowing for a photocopy or faxed copy of the signature, but not allowing for a true "electronic" signature, as that term is commonly understood.

The proposed Regulations change the definition of "signature card" to include "electronic data" that constitutes the signature of a person authorized to give instructions in respect of the account. In addition, a "signature" is now defined to include an electronic signature or other information in electronic form that is created or adopted by a client and that is accepted by the regulated entity.

The effect of these changes is to allow for a true electronic signature that can be compliant with the Regulations, thereby facilitating account openings in the non-face-to-face environment.

Again, as with identity verification, these proposed changes update the Regulations to be more responsive to the digital environment in which regulated entities operate.

These provisions come into force on registration of the Regulations.

Politically Exposed Persons

One other matter that the proposed Regulations accomplish is the implementation of the changes made to the PCMLTFA under Bill C-31 in respect of PEPs. For more information, see our April 2014 *Blakes Bulletin: Important Changes to Canada's AML Laws: Here We Go Again*.

In that regard, the proposed Regulations expand certain of the regulatory requirements that currently apply to foreign PEPs to include domestic PEPs as well as the heads of international organizations or family members or close associates of such persons.

In respect of the requirements on account opening (for financial entities and securities dealers) the proposed Regulations now require the regulated entity to take reasonable measures to determine whether the account is being opened not only for a foreign PEP, but also for a domestic PEP, a head of an international organization, a family member of one of those persons or a person who is closely associated with a PEP (PEP Related Person).

Moreover, the requirement in the Regulations imposed on both financial entities and securities dealers to take reasonable measures to determine if existing high risk account holders are foreign PEPs has been removed. Instead, financial entities and securities dealers will be required to take reasonable measures on a periodic basis, to determine if an existing account holder is a PEP Related Person. It is significant that there is no mention of "high risk" account holders in this provision, but rather, this periodic monitoring requirement applies in respect of all account holders. As a result, regulated entities subject to this requirement will have to build processes and procedures to address this monitoring requirement.

In addition to the foregoing, in respect of PEP Related Persons, the proposed Regulations also provide that where a financial entity or securities dealer (or any of their employees) detect a fact that could reasonably be expected to raise reasonable grounds to suspect that a person who is an existing account holder is a PEP Related Person, the financial entity and securities dealer are required to take reasonable measures to determine whether the account holder is in fact such a person. Presumably, FINTRAC guidance will provide what circumstances would raise such "reasonable grounds," but it would appear that this new provision

implicitly requires regulated institutions to implement additional monitoring procedures for PEP Related Persons.

While the proposed Regulations require securities dealers and financial entities to implement requirements to determine if account holders are PEP Related Persons, the corresponding requirements to determine the source of funds to be deposited in the account, to obtain senior management approval to keep the account open and to engage in enhanced ongoing monitoring, only apply on an absolute basis to foreign PEPs and their family members and close associates. In respect of the requirements for domestic PEPs, heads of international organizations, family members or close associates of such persons, these additional requirements will only apply where the regulated entity considers, based on their risk assessment, that the risk of a money laundering or terrorist activity financing offence is high.

Accordingly, based on these new provisions in the Regulations, it is clear that monitoring for domestic PEPs, heads of international organizations and their close associates and family members as well as the transactions that they engage in is now the "new normal" for regulated entities.

The amendments to the Regulations in respect of transactions of C$100,000 or more that apply to financial entities, money services businesses and life insurance companies parallel the changes made in respect of accounts. Accordingly, regulated entities will now be required to determine if a triggering transaction for a C$100,000 or more is undertaken by any PEP Related Person. However, the accompanying requirements that apply to foreign PEPs (determining the source of funds, senior management review) will only apply to domestic PEPs, heads of international organizations and their family members and close associates, if the regulated entity, based on their risk assessment, considers that there is a high risk of money laundering or terrorist financing offence.

A final change to the PEP provisions that may help to alleviate the additional regulatory burden somewhat is in respect of timing requirements in which regulated entities are required to make a PEP determination. While the current regulations require the PEP determinations and accompanying review/approvals to be conducted within 14 days, the proposed Regulations extend this period to 30 days.

The new PEP requirements do not come into force until one year from the date of registration of the Regulations.

Risk Assessments

The Regulations currently prescribe the factors that regulated entities must consider in performing their risk assessments including clients and business relationships, products and delivery channels and the geographic location of activities. The proposed Regulations add two additional factors that must be considered in performing a risk assessment. These factors are:

- Any new developments in respect of, or the impact of new technologies on, the regulated entity's clients, business relationships, products or delivery channels or the geographic location of their activities
- For a regulated entity that is a financial entity or securities dealer, any risk resulting from the activities of an affiliated Canadian financial entity or securities dealer or from the activities of an affiliated foreign entity that carries out similar activities

While arguably the factors set out in the first item above are already encompassed by the current regulatory requirement to consider "any other relevant factor" in the risk assessment, the additional factors that apply to financial entities and securities dealers set out in the second item above may prove to be very challenging and will likely require an in-depth analysis of their global businesses. It is noted, however, that this requirement is consistent with the concept of "enterprise wide" compliance, which is becoming the regulatory expectation of regulators in Canada and globally.

These new requirements will come into force one year after registration of the Regulations.

Reasonable Measures

There are numerous provisions in the Regulations that require regulated entities to take "reasonable measures" to perform certain actions or obtain certain information. Examples of these reasonable measure requirements include making third-party determinations, completing all information required on reporting forms, and making PEP Related Person determinations.

The proposed amendments provide that if the reasonable measures taken are unsuccessful, regulated entities must keep a record that sets out the measures taken and why they were unsuccessful. These provisions do not come into force until one year after registration of the Regulations.

Suspicious Transactions

The proposed Regulations also make a few minor changes to the STR Regulations. However, amid those changes, there is one significant change that is worth noting. Currently, the requirement to file suspicious transaction reports under the STR Regulations arises where a regulated entity first detects a fact "…that constitutes reasonable grounds to suspect that the transaction is related to the commission of a money laundering or terrorist activity financing offence." Accordingly, in order to be required to file a suspicious transaction report, a regulated entity must have a fact that constitutes reasonable grounds. However, the amendments to the STR Regulations now provide that such a report must be filed whenever a regulated entity detects a fact respecting a financial transaction "that could reasonably be expected to raise reasonable grounds" that the transaction is related to a money laundering or terrorist activity financing offence. As such, the standard for filing a suspicious transaction report changes from "constituting reasonable grounds" to "reasonably expected to raise reasonable grounds." Although this seems like a simple wording change, in fact the new language lowers the threshold for reporting under the STR Regulations. This will be something that regulated entities will need to take into consideration going forward in making determinations in respect of the filing of suspicious transaction reports. This provision comes into force on registration of the Regulations.

There are other amendments made by the proposed Regulations, including modifying the requirement to obtain client credit files, a new definition of affiliated entities, some modifications to the record keeping requirements and some transitional matters. Stakeholders have a period of 60 days to provide any comments on these Regulations. As such, regulated entitles are best advised to review these provisions and submit comments to the Department of Finance if they have any material concerns.

If is noteworthy that not all of the regulatory changes addressed in Bill C-31 were made under this set of amending regulations. As such, there are clearly more amendments to come.

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