August 16, 2013

Delivered By Email: consultations@fintrac-canafe.gc.ca

Financial Transactions and Reports Analysis Centre of Canada
234 Laurier Avenue West
Ottawa, Ontario
K1P 1H7

Dear Sirs/Mesdames:

RE: Consultations on Updated FINTRAC Guidelines – Customer Due Diligence

The Members of Investment Funds Institute of Canada ("IFIC") thank FINTRAC for providing an opportunity to comment on the proposed changes to FINTRAC's Guidelines 4 and 6, which are being updated in response to the Regulations Amending the Proceeds of Crime (Money Laundering) and Terrorist Financing Regulations ("Regulations") necessitated by the Financial Action Task Force's Recommendation 10 on Customer Due Diligence. Our comments will focus on Guideline 4 and Guideline 6E (Record Keeping and Client Identification for Securities Dealers), being the sector into which our Members have been classified.

In addition to our Members' comments on the amended Guidelines, we are also providing responses to the general questions posed in your email to the undersigned dated July 16, 2013.

Unique Distribution Structure of Investment Funds Industry

As we have noted in our previous submissions, the unique distribution structure in the investment funds industry in Canada creates unique issues that are now recognized by the revised Regulations, and which we propose be more clearly described in the Guidelines. Our comments are focused on this unique structure to ensure that the Guidelines provide more clarity. On this basis we feel it useful to reiterate a brief summary of this distribution structure and how the industry has developed its model of AML compliance.

In Canada investment funds are managed by registered investment fund managers. The units and shares of these funds are sold through registered investment dealers or mutual fund dealers that may be related to, or may be independent of, fund managers. An investor purchases units in Canadian mutual funds through an advisor who is employed by a dealer firm. As a result, an investment fund manager does not deal directly with clients prior to the purchase of the manager's funds, and the manager must rely on the dealers to obtain and retain all necessary identity verification information about the clients. Fund managers have very little additional information about investors in their funds.

Funds may issue units either in the name of the beneficial owner (in "client-name") or in the name of an intermediary or nominee, generally a custodian or broker holding an aggregation of units in a particular fund for a number of clients who have purchased those units (in which case the units would be issued in "nominee name"). When units are sold in nominee name, the units are recorded under that intermediary's omnibus account. The custodian or broker also maintains client-name accounts, including the specific identity information and other documentation for each client that purchases units through the intermediary. Fund managers generally do not have access to this client information.

For many years the industry has operated comprehensive client identification, account monitoring and suspicious transaction reporting procedures that are allocated between dealers and investment fund managers (the "Allocated Compliance Model") as permitted by the exception in section 62(1)(b)(i) of the Regulations. The industry takes its AML/ATF obligations seriously and has for years relied on this successfully implemented Allocated Compliance Model.

In the Allocated Compliance Model once a purchase transaction with a client has settled the fund manager is in a position to monitor ongoing transactions of that client, but only in mutual funds managed by that manager. Dealers and investment fund managers both submit suspicious transaction reports to FINTRAC, in respect of suspicious client activity in their accounts, or in respect of such activity in clients' mutual fund investments.

Section 62(1)(b)(i) of the Regulations recognizes the effectiveness of the Allocated Compliance Model described above, providing investment fund managers with an exemption from the record-keeping and identification requirements, where there are reasonable grounds to believe dealers have ascertained client identity as required. Fund managers are permitted to rely on the dealer to perform these obligations, which obviates the need for them to repeat information collection and recordkeeping already performed by a dealer. This is an effective and cost-efficient compliance method that also ensures that sensitive personal client information is not collected and maintained by more firms than is necessary to adequately perform the AML requirements (keeping that information to one entity that is covered by privacy and AML obligations minimizes possible contraventions of privacy legislation). In cases where funds might be distributed without the intermediation of a distributor, such as with institutional clients in certain circumstances, the fund manager will perform all of the client identification, recordkeeping and, if triggered, reporting obligations.

The exemption in Section 62(1)(b)(i) incorporates existing business processes to avoid unnecessary duplication of administration, and has resulted in a very effective AML/ATF system within the investment funds industry.

General Comment on Proposed Updated Guidelines

As a general comment, we believe that the proposed updates to Guidelines 4 and 6E are helpful to further clarify the requirements in the Act and Regulations, to improve our Members' AML/ATF policies and procedures, and to enhance the value of the Guidelines as reference documents. However we have several comments and suggestions regarding the Guidelines and their particular guidance to our industry.

Comments on Proposed Updates to Guideline 4

With respect to the risk assessment guidance in section 6.1 of Guideline 4, our investment fund manager Members note that they do perform risk assessments of clients in a manner that is appropriate to each of them, however their client identification and information updating activities reflect the fact that the industry uses the Allocated Compliance Model and hence are read in the context of Guideline 6E which contains more specific guidance. Where investment fund managers can reasonably rely on mutual fund dealers to perform client identification and updating of client identification information, the investment fund managers need not repeat those activities. Nevertheless, if their risk assessment determines that a particular client be treated as high risk, they will take the appropriate enhanced measures and, where necessary, file suspicious transaction reports.

On page 24 of the Guideline, one of the Exceptions to obtaining information on beneficial ownership and control is "a group plan account held within a dividend or a distribution reinvestment plan if the sponsor of the plan is an entity that trades shares or units on the Canadian stock exchange and operates in a country that is a member of the Financial Action Task Force". We note the reference to "the" Canadian stock exchange and seek clarification on

whether FINTRAC meant to refer to "a" Canadian stock exchange, given that there are currently several authorized stock exchanges in Canada?

Comments on Proposed Updates to Guideline 6E

In several parts of Guideline 6E there are references to requirements to record the nature and purpose of the business relationship as well to requirements that require reasonable measures be taken to ascertain a client's identity. Given this Guideline is intended to clarify the requirements for securities dealers, we believe it would be enhanced if it included the wording of the mutual fund dealers exemption from the amended definition of "business relationship", as published in the Regulatory Impact Analysis Statement accompanying the amendments to the Regulations, published in the Canada Gazette on January 31, 2013. The Statement reads, in relevant part,

> **"**The definition of "business relationship" in subsection 1(2) has been amended by clarifying the particular activities and transactions that are exempt from or included in the definition of "business relationship," in particular:
>
> - Accounts opened by mutual fund dealers are exempt from the definition of "business relationship" where there are reasonable grounds to believe that the identity of the account holder has previously been ascertained by a securities dealer;"

Our Members request that FINTRAC include the above statement in Guideline 6E, and that it add more clarification to the content under the heading "Exception" in Section 5. We do not believe the current language under this heading is entirely clear or accurate, particularly the last sentence in the second paragraph which reads "The obligation to conduct ongoing monitoring of the business relationship with that client would apply."

The issue is whether mutual fund dealers that rely on the section 62(1)(b) exception need to conduct ongoing monitoring of their client relationships where they need to file a suspicious transaction report. Our members respectfully submit that the regulations do not contain that requirement, for the following reasons.

We accept that the activity that triggers a suspicious transaction report, but not any other activity, would fall into the definition of "business relationship", because section 62(1)(b) would not apply to the activity. Section 62(1)(b) would apply to all non-suspicious activity occurring before and after the suspicious activity.

The requirement for a securities dealer to conduct ongoing monitoring of its business relationships is contained in section 57.2. That section requires a securities dealer to conduct ongoing monitoring of its business relationships only where the securities dealer is required to ascertain the identity of any person or confirm the existence of any entity in accordance with section 57. Section 57.2 does not apply where identity in the case of a suspicious or attempted suspicious transaction is required to be ascertained pursuant to section 53.1. Section 53.1 is a separate client identification obligation from the client identification obligation in section 57. Consequently, the requirement for a mutual fund dealer that relies on the 62(1)(b) exemption to ascertain the identity of any person or confirm the existence of any entity conducting a suspicious or attempted suspicious transaction pursuant to section 53.1 does not trigger the section 57.2 requirement to conduct ongoing monitoring of a business relationship. This is logical since the transaction that triggers the suspicious transaction report and falls within the definition of "business relationship" is a single, discrete transaction which has already occurred and which cannot be monitored as if it were an ongoing business relationship.

In order to clarify the content under the heading "Exception" in Section 5, we suggest the heading "Exception" be amended to read "Exceptions to Business Relationships", and we suggest the first two paragraphs beneath that heading be amended to read, as follows:

Exceptions to Business Relationships

The business relationship does not include any transactions or activities of clients that fall within an exemption from client identification requirements as described in section 4.2 – "General exceptions to client identification". For example, accounts opened by mutual fund dealers are exempt from the definition of "business relationship" where there are reasonable grounds to believe that the identity of the account holder has previously been ascertained by a securities dealer.

Even if your client falls within a client identification exemption and thus the business relationship exemption, if you have to send a suspicious transaction report in respect of the client, then you must ascertain the identity of the client or confirm the existence of a corporation or other entity (subject to the circumstances described in section 4.4). However, you do not need to conduct ongoing monitoring of the business relationship with that client.

Responses to FINTRAC's General Questions about the Guidelines

In its email sending out the proposed amended Guidelines to commentators, FINTRAC posed four general questions on which it specifically seeks comments. Those questions, followed by the responses of our Members, are:

1. Generally speaking, how do you use FINTRAC's Guidelines?

Our Members report that the Guidelines are extremely useful to help them develop and update their AML policies and procedures. The Guidelines are used to understand the practical application of the requirements of the Act and the Regulations and are considered great source documents.

2. As you know, we have updated Guidelines 4 (Implementation of a Compliance Regime) and 6 (Record Keeping and Client Identification) to reflect amendments to the Regulations requiring the creation of a new business relationship record and the monitoring of business relationships. Based on your reading of the Guidelines, do you understand what you need to do to meet your obligations, respective to:

a. the business relationship record

b. monitoring the business relationship?

Our Members generally understand quite well what they need to do to meet their obligations with respect to business relationship records and monitoring the business relationship. There is a question as to what is meant by "non-account based business relationship." It is difficult to imagine transactions being conducted in the investment fund world without the existence of an account. As noted in the specific comments earlier in our letter, the existence of the exemption from the business relationship for mutual fund dealers where there are reasonable grounds to believe that the identity of the account holder has previously been ascertained by a securities dealer is a significant item that should be expressly noted in Guideline 6E.

As a general comment, for future consultations it would be useful if FINTRAC could draw attention to the particular changes, and the reasons underlying those changes, that have been proposed to permit commentators to focus on those changes.

3. Based on your reading of the Guidelines, how do you plan to implement these changes in your business?

Our Members noted they expect to implement the changes in the Guidelines as necessary to comply with the new rules, updating their current policies and procedures as is appropriate. Precise implementation processes are still under consideration.

4. Do you feel the Guidelines require further clarification on any of the new aspects? (If yes, in what way(s)? If no, why not?)

Our Members have reported that, at the present time, beyond those areas where we are seeking clarification in our letter, it is too early to conclude whether any further clarification is needed.

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We thank you in advance for your consideration of our comments. We would be pleased to meet with you to discuss our comments and suggested clarifications.

Please do not hesitate to contact me at 416-309-2214 or by email at rhensel@ific.ca if you have any questions or require any additional information.

Yours truly,

THE INVESTMENT FUNDS INSTITUTE OF CANADA

Ralf Hensel
General Counsel, Corporate Secretary
and Director of Policy (Fund Manager Issues)