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Financial Sector Division
Department of Finance
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Dear Ms Anderson:

Re: Regulations Amending the Proceeds of Crime (Money Laundering) and Terrorist Financing Regulations

The Investment Funds Institute of Canada ("IFIC") thanks the federal government for providing an opportunity to comment on the proposed regulations to amend the *Proceeds of Crime (Money Laundering) and Terrorist Financing Regulations* ("PCMLTFR").

As we have noted in our previous submissions, the unique distribution structure in the investment funds industry in Canada is the basis for our below comments on the proposed changes to the PCMLTFR.

We would like to remind the Department of Finance that investment funds in Canada are managed by registered investment fund managers and the units and shares of the funds are sold through registered investment dealers or mutual fund dealers that may be related to or independent of fund managers. An investor purchases units in Canadian mutual funds through the distributor or dealer firm. Thus, 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.

As well, funds may issue units either in the name of the beneficial owner (in "client-name") or through an intermediary or nominee, generally a custodian or broker (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 information.

For many years the Canadian mutual funds 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 PCMLTFR. The industry takes its AML/ATF obligations seriously and has for years relied on its successfully implemented Allocated Compliance Model.

In the Allocated Compliance Model once a purchase transaction with a client has settled the fund manager is then in a position to monitor ongoing transactions of that client 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 PCMLTFR recognizes the effectiveness of the Allocated Compliance Model described above, providing mutual fund companies 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 manager will perform all of the client identification, recordkeeping and, if triggered, reporting obligations.

The PCMLTFR amendments must not in any way eliminate or compromise the exemption in Section 62(1)(b)(i). This exemption is well reasoned, 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. Our members would be very concerned about any changes, proposed or resulting, to the allocation of responsibilities between dealers and fund managers.
It is in the above context that IFIC, on behalf of its members, would like to make the following comments on the proposed amending regulation:

1. The term "business relationship" as defined in the amendments is too broad, particularly in the context of the unique relationship between fund managers and fund dealers in the investment fund industry as described above. The proposed definition of "business relationship" could impact the client-name account business and the nominee relationships requiring fund managers to duplicate the dealers' ongoing monitoring, and establishing the purpose of business relationships, when identifying or reporting suspicious or terrorist financing transactions.

   It is also a possible interpretation that the nominee dealers (who are currently responsible for ascertaining identity) could be viewed as the "client" under the definition of "business relationship". If this were to be the case, fund managers may need to perform the additional due diligence on the dealer firms as proposed by the amendments. We do not think that this is an intended or desired result of the amendments.

   IFIC's members request guidance on what situations are intended to be considered "business relationships". For example, is the relationship between a mutual fund manager and a dealer, or a nominee, intended to be included, or is it only a relationship between any of these entities and an investor? Further, it would appear that registered plans are exempt from the definition of "business relationship", but that non-registered accounts are not exempt. Was this intentional? Is there a policy rationale for this distinction?

2. With respect to the definition of "ongoing monitoring", the amendments need to clarify the frequency of such monitoring and what is expected by the phrase "periodic basis". The requirement to conduct ongoing monitoring seems to apply when detecting reportable

transactions, reassessing the risk level or keeping the client identification information up to date. Fund managers who sell their funds primarily through third-party dealers may not be in a position to determine whether the transactions are consistent with the information obtained by the dealer about the ultimate client of the dealer, or the dealer's risk assessment of that client or transaction. Again, in the context of the Allocated Compliance Model, fund managers should be able to rely primarily on the dealers to make these determinations.

3. In a number of sections, the phrase "reasonable measures to obtain" has been replaced simply with "obtain", particularly in the context of corporate entities with accounts. Does this mean that it will no longer be sufficient to request and take other reasonable steps to acquire this information, and that entities will now be expected to do everything possible to obtain this information? Or would it be sufficient for our members to obtain the identity of a senior management person of the entity and then treat this account as a high risk account with extra monitoring?. (Section 11.1(1) of amended Regulations)

4. Also section 11.1(2) of the amended Regulations contains a requirement for "reasonable measures to confirm accuracy" of information. What does that entail? To what degree must our members actually "confirm" information?

5. In sections 54.3, 54.4, and 57.2 of the proposed amending regulations, which require ongoing monitoring of business relationships, again IFIC and its members require clarification around what is meant by the "business relationship", particularly in the context of the unique Allocated Compliance Model used in the investment funds industry, in order to be able to ensure compliance.

6. Regarding sub-sections 71.1(a) and (b), which require enhanced measures to ascertain the identity of any person or to confirm the existence of any entity along with enhanced measures to mitigate risks, including keeping client identification information "up to date", we request clarification on what is intended by the phrase "up to date". Is it a review once every year, or more (or less) frequently? Is it to be left to each entity's compliance/risk program to determine based on their business model?

7. The interaction of the proposed new section subsection 62(5) with the exemptions in subsections 62(1), (2) and (3) leave it unclear when those exemptions would in fact apply. Our interpretation is that the client identification requirements will apply in all cases (and hence the exemptions will not be available) where the person or entity is required to take reasonable measures to ascertain identity. It appears that this new provision essentially nullifies the exemptions in most cases. If our interpretation is correct, this would seriously impede the investment fund industry's ability to continue to rely on the Allocated Compliance Model, a regressive step with which we do not agree. We believe section 62(5) should include clear language which continues to make those exemptions applicable where there are reasonable grounds to believe identity has already been ascertained by the dealer, or otherwise clarify that the exemptions continue to apply in accordance with their terms. If there is a desire to use 62(5) to limit the application of those exemptions in some cases, those limitations must be clearly defined.

8. There are enhanced "entity" due diligence requirements that go beyond the former requirement to validate the existence of the entity and the identity of directors, and now include requirements for formal trusts and "other types of entities". This would appear to require our members to collect information establishing the ownership, control and structure of the entity. We are concerned about the ability of our members, operationally, to meet this

requirement. For example, will a letter provided by a corporate secretary of the entity be sufficient? How should our members deal with private corporations where there is no independent public information to verify what may have been provided by the entity? How are significant shareholders of a private corporation to be identified? What is an acceptable process to document the reasonable measures taken to obtain this information? We would greatly appreciate clearer guidance as to how this requirement should be implemented and complied with.

9. We are also concerned about the amount of time that will be given to comply with the amendments once they come into effect. Our industry does rely to a significant extent on Guidance that is produced to assist with interpretation and compliance with these regulations. Therefore we request that the Department of Finance provide sufficient implementation time after the date of coming into force of the amended regulations and the date of release of any Guidance before compliance with the amended requirements will begin to be required of our members.

We thank you in advance for your responses to our concerns, and for providing clarification on the issues we have identified in the next iteration of the proposed amendments to the PCMLTFR and/or in any Guidance to be produced by the Department of Finance or FINTRAC.

Please do not hesitate to contact me if you have any questions, or require any additional information in relation to our comments.

Yours truly,

THE INVESTMENT FUNDS INSTITUTE OF CANADA

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