THE INVESTMENT FUNDS INSTITUTE OF CANADA
L'INSTITUT DES FONDS D'INVESTISSEMENT DU CANADA

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December 22, 2011

Ms. Leah Anderson
Director, Financial Sector Division
Department of Finance
140 O'Connor Street
Ottawa, Ontario
K1A 0G5

Dear Ms. Anderson:

Re: Consultation Paper on Proposed Amendments to the *Proceeds of Crime (Money Laundering) and Terrorist Financing Regulations* on Ascertaining Identity

On behalf of The Investment Funds Institute of Canada ("IFIC") and its members, we thank you for the opportunity to provide our comments in respect of the Consultation Paper on the Proposed Amendments to the *Proceeds of Crime (Money Laundering) and Terrorist Financing Regulations* on Ascertaining Identity (the "Consultation Paper").

IFIC is the national association representing Canada's investment funds industry. Our members comprise investment fund managers, fund distributors and organizations that provide services to the investment fund industry (e.g., legal, administration and accounting firms). Funds offered by IFIC members are typically structured as trusts or corporations, the interests in which are sold through retail distribution channels, that is, through registered securities dealers that may be related to or independent of fund managers. As of November 2011, there were over 2,400 mutual funds in Canada, with total assets under management of CAD $773 billion.

We hope that our comments will provide relevant information regarding our industry and that, with this knowledge, the Department of Finance will better appreciate when and to which of our members the proposed amendments should apply, and how implementation may be shaped to ensure that the appropriate requirements are applied at the appropriate points of contact with clients.

We appreciate the overall objectives of the proposed amendments set out in the Consultation Paper. The Canadian mutual funds industry has had comprehensive client identification, account monitoring and suspicious transaction reporting procedures in place for a number of years. At the time of the last revisions to the Act, Regulations and FINTRAC Guidelines, IFIC and

its members detailed the generally-applied business processes that exist in this industry and the requirements were interpreted in a manner that recognized those processes, while still completely fulfilling the requirements. Those business processes have not changed; however for greater certainty we are providing a brief reminder of the transaction process, and how the parties perform their respective AML functions.

Mutual Fund Account Opening and Transaction Process

Investment funds in Canada are generally structured as trusts or corporations. The funds are managed by an investment fund manager and the units and shares are sold through retail distribution channels, that is, through registered dealers that may be related to or independent of fund managers. An investor purchases securities in Canadian mutual funds through a distributor or dealer, not directly from the fund manager. In both cases, mutual funds will generally sell their securities to investors on a continuous basis and the shares/units are redeemable at any time.

Mutual funds in Canada are subject to general regulatory oversight under securities legislation. All fund securities must be sold to the public either through prospectuses that are filed with and cleared through a securities commission or pursuant to a prospectus exemption (generally an "accredited investor" exemption). Dealers that distribute the funds must be registered in each province in which they have clients and they are also subject to examinations by provincial securities commissions and self-regulatory organizations (e.g., Investment Industry Regulatory Organization of Canada (IIROC) and the Mutual Fund Dealers Association of Canada (MFDA)). The dealers' sales representatives and advisors are also licensed. Dealers and advisors are subject to stringent account-opening and know-your-client requirements under securities legislation, as well as the anti-money-laundering/anti-terrorist financing client identification requirements.

Funds may issue shares or units either in the name of the beneficial owner (client-name) or through an intermediary or nominee, generally a custodian or broker. When shares or units are sold through a custodian or broker, the shares or 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 fund units through the intermediary. Fund managers generally do not have access to this information.

Advisors are the client-facing representatives who first establish the business relationship with the client, obtaining the required information about the client's identity, risk tolerance and investment objectives. This information is all gathered as part of the account opening process. Clients may open several accounts with a dealer, often having different investment objectives/intended uses for registered accounts (such as RSPs and RIFs) and non-registered

accounts. The fund manager is not aware of any of such intended use information other than the type of account and the investments being made.

Once the client decides to purchase securities in one or more mutual funds, information necessary to execute a purchase transaction is passed on to the manager(s) of that/those fund(s). An investment fund manager does not deal directly with clients prior to the purchase of the manager's funds, and must rely on the dealers to obtain and retain all necessary identity verification information about the client. 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 securities managed by that manager. Both dealers and investment fund managers submit suspicious transaction reports (STRs) to FINTRAC, in respect of suspicious client activity in their accounts, or in respect of such activity in clients' investments in funds.

Our Comments on Specific Proposals

It is in the light of these business processes, and the various roles of managers and dealers, that we submit the following comments on the proposed amendments.

Proposals 2.1 and 2.2

Existing FINTRAC guidance states that additional client identification need not be performed if doing so would tip off the client regarding the STR[1]. Nowhere in the language of the Guideline is there any indication that this guidance does not apply equally to investment fund managers; and managers, in fact, do rely on this guidance in fulfilling their AML requirements. Our investment fund manager members are concerned that the proposed amendments may impose on them a requirement to ascertain the identity of individuals who conduct suspicious transactions or attempted suspicious transactions, when that identifying information has already been obtained by a dealer at the time of account opening.

As we have noted, fund managers and dealers perform the ongoing monitoring of their mutual fund accountholders and also report suspicious transactions to FINTRAC. The obligation to report comes with an obligation to not tip the client about the report. Requiring the dealer to reconfirm identity information may alarm the client that a transaction is considered suspicious, which may result in tipping. Since fund managers rely on dealers to obtain client identification information and they cannot easily reconfirm a client's identity directly, requiring them to perform client identification measures when they file an STR could jeopardize the anonymity of those transaction reports. A manager request for confirming information from the dealer or advisor increases the risk of tipping.

[1] FINTRAC Guideline 2: Suspicious Transactions, Section 4 "How to Make a Suspicious Transaction Report".

As such, we request confirmation that fund managers would not be obligated to ascertain identity for the purposes of suspicious transaction reporting, and that dealers and fund managers can continue to use their best efforts to provide the identity information that is available to them when filing such reports. For greater certainty, we request confirmation that the FINTRAC guidance in Guideline 2 continues to apply notwithstanding the proposed amendments.

Proposal 3.1

This proposal would require reporting entities to obtain beneficial ownership information of corporate, entity or trust clients, and to take reasonable measures to ascertain such information. We have concerns on several levels. Pursuant to securities regulations (or IIROC Rules for members of that organization) dealers are already required to establish the identity of beneficial owners for entities. The proposal would increase the onus on dealers so that they would almost have to perform a forensic investigation of beneficial ownership. In light of current laws governing privacy and access to information, as a practical matter dealers will find it difficult to do more than take reasonable steps to obtain such information. Such practical limitations must be recognized and respected in the proposed amendments and in any FINTRAC Guideline that is issued in connection with these amendments.

In spite of this limitation, it is the dealers that are best suited obtain identifying and beneficial ownership information and this information is passed on to the investment fund manager. The manager is not in a position to contact the client to ascertain this information and relies on the dealer firm to have properly met this information requirement. Again, industry practice obligates the manager to monitor the transactions that clients make in that manager's funds. If the manager is also expected to obtain beneficial ownership information from its retail clients, it would significantly alter the business model and duplicate the information gathering process in place at the dealer level. If the Department of Finance no longer agrees that this two-party shared process is acceptable for fulfilling the obligations under the Regulations, we request the Department's feedback, or further detailed guidance from FINTRAC in this area.

Proposal 3.3

This proposal would amend the Regulation to require ongoing monitoring in respect of the business relationship. However the proposed amendment does not define "business relationship" – is it intended that this be broader than the dealer and/or investment fund manager's usual business interactions with the investor?

As we noted, a client may open one or more accounts with a dealer, and in each account the client may purchase mutual funds of several managers.

From the perspective of the dealer, the business relationship is limited to providing advice to the client on its investment objectives and to recommend securities that are suitable for the client that are expected to meet those objectives. However, the proposed amendments suggest that a much deeper, forensic investigation of beneficial ownership is required to be performed. Given the laws governing privacy and access to information, we would suggest that reasonable limits on this requirement must be in place, as there is clearly a finite amount of information a dealer can obtain by legal means.

From the perspective of each investment fund manager the funds of which are purchased by a client, the business relationship is limited to the client's transactions in the units of that manager's funds. Managers already perform general monitoring of transactions by their clients. Those clients that are considered to be high risk are generally given special attention. STRs, however, are filed as suspicious activity arises, and are not limited to clients that are considered to be high risk.

As such, we believe that our dealer members are already fulfilling the identification requirements, both in respect of the client and the business relationship, and our manager members are already meeting the monitoring requirements that are proposed in the Consultation Paper. Applying the obligation also to managers to obtain beneficial ownership information would significantly alter their business model and would provide no added value, but simply duplicate activity already performed by dealers.

Proposal 3.4

This proposal would require reporting entities to maintain records setting out the purpose and intended nature of a business relationship between the reporting entity and its customer. Again, in the mutual funds industry it is the dealers/advisors that open the accounts with mutual fund clients and obtain all required information at that time. The vast majority of clients are opening accounts "to invest money", either generally or for retirement, or both. The account opening form typically seeks no further information about the purpose of the account. The dealer/advisor will often verify that the client's stated investment objective is suitable for the nature of each account that has been established.

Is the Department of Finance proposing that dealers/advisors must probe for more account purpose information beyond "for retirement savings" to determine if there is an ulterior purpose beyond what the client has stated? Is the expectation that the dealer/adviser needs to be reasonably certain that a stated purpose of "for retirement savings" is the client's legitimate purpose?

We also request clarification whether this new proposed information requirement will be necessary for new accounts only on a going-forward basis, or are dealers expected to also review all existing active accounts to attempt to verify and document the clients' true purpose?

In addition we seek clarification that this proposal does not apply to investment fund managers due to the limited nature of their relationship with investors in their funds.

With respect to previous amendments to the Regulations, FINTRAC's Guidelines did provide detailed and specific industry examples of the expectations and they did interpret the regulations in a manner consistent with the generally-applied industry practices we detailed above, recognizing the shared performance of obligations between dealers and managers. We trust that we may rely again on FINTRAC to craft its Guidelines in a similar manner this time, providing such helpful assistance once more.

Our members are concerned about the expected timing of implementation of the amended Regulations. Given other major regulatory initiatives being implemented at the present time, and our expectation that significant time will be needed to fully change systems and procedures to meet these new requirements, our members propose that a 3-year period for implementation of the amendments be provided.

We would very much appreciate an opportunity to meet with you to elaborate on and discuss our concerns and answer any questions that you may have. To contact us to arrange such a meeting, or to seek any clarifications in the meantime, please do not hesitate to contact Ralf Hensel, IFIC's General Counsel, Corporate Secretary and Director, Policy – Manager Issues at rhensel@ific.ca or (416) 309-2314.

Yours sincerely,

Joanne De Laurentiis
President and CEO