September 4, 2015

Delivered By Email: fcs-scf@fin.gc.ca

Lisa Pezzack
Director
Financial Systems Division
Financial Sector Policy Branch
Department of Finance
90 Elgin Street
Ottawa, Ontario
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Dear Ms. Pezzack:

Re: Response to Consultation on Proposed Regulations Amending Certain Regulations Made under the Proceeds of Crime (Money Laundering) and Terrorist Financing Act, 2015, as published in the Canada Gazette on July 4, 2015

We are writing on behalf of members of The Investment Funds Institute of Canada ("IFIC") to comment on the Proposed Regulations Amending Certain Regulations Made under the Proceeds of Crime (Money Laundering) and Terrorist Financing Act, 2015, as published in the Canada Gazette July 4, 2015 (the "Proposals").

We appreciate the opportunity to provide our comments on the Proposals. IFIC represents the vast majority of Canadian investment fund managers and fund distributors, and is assisted in its work by the organizations that provide services to the investment fund industry (e.g., legal, administration and accounting firms). Funds offered by IFIC members are sponsored and managed by registered investment fund managers, and units in these funds are sold through registered investment and mutual fund dealers, that may be related to or independent of fund managers, through their networks of individual advisors[1]. As of July 31, 2015, total mutual fund assets under management exceeded CAD $1.24 trillion.

We appreciate the efforts that Finance has made to address concerns raised by the industry in earlier consultations, and are generally pleased with the amendments intended to facilitate and ease the burden of compliance on reporting entities.

However, we have identified some concerns and inconsistencies with respect to the proposed amendments. Our comments include several areas where we believe additional clarification is needed, primarily in the regime for identification of politically exposed persons, and regarding the coming into force provisions.

[1] Investment fund managers and dealers have been collectively defined in the Proceeds of Crime (Money Laundering) and Terrorist Financing Regulations under the term "securities dealers" which means persons or entities that are authorized under provincial legislation to engage in the business of dealing in securities or any other financial instruments or to provide portfolio management or investment advising services.

Politically Exposed Persons Regime

Determination of Politically Exposed Persons (PEP) Generally

Proposed section 57.1 of the Regulations appears to require securities dealers to "take reasonable measures" to determine whether persons opening accounts are "closely associated with" politically exposed foreign persons (PEFPs), politically exposed domestic persons (PEDPs), heads of international organizations (HIOs) and family members of one of those persons.

It is unclear what is meant by "closely associated with" in the context of this requirement. As such, we request more clarity, a definition and/or examples as to what "closely associated with" means.

In addition, the industry is unable to determine with any certainty what "taking reasonable measures" would constitute. What would be considered reasonable measures for determining whether a securities dealer is dealing with a close associate, given how broad the definition appears to be? Based on the discussion in the "Small business lens" section of the Regulatory Impact Analysis accompanying the draft amendments[2], we confirm it is the government's expectation that, at the time of account opening, a direct request to the client as to whether the client is a PEDP or HIO constitutes a "reasonable measure".

To allow reporting entities generally, and the investment funds industry in particular, to properly and efficiently meet the PEP determination obligations, we request that the government or FINTRAC create and maintain a formal list of PEDPs and HIOs that the industry will be able to reference. In the absence of such a government-managed list, what other reasonable measures are acceptable for a reporting entity: attestation by one of its principals; public-source information searches? The Regulatory Impact Analysis Statement indicates that the government is sensitive to, and is concerned with minimizing, the impact of these requirements on small businesses. However, we believe the requirement to identify PEDPs and HIOs, as well as family members and close associates of such persons, using only their own means and resources, will create a significant financial burden on businesses of all sizes. Additionally, the results, based on a subjective interpretation of "close associates", may capture individuals that do not necessarily need to be captured or monitored. If the government intends to move forward with such a broad PEP determination requirement, it should concurrently establish an efficient, centralized solution to allow all reporting entities to comply with their requirements at a reasonable compliance cost.

In this regard, we believe that the cost of the amendments quoted in the Regulatory Impact Analysis Statement significantly understate the financial impact that will be borne by reporting entities having to identify PEDPs, HIOs, and the family members and close associates of such persons.

Determination of PEPs at Account Opening

To assist us in interpreting the language in Section 57.1(1), we have examined the Department of Finance's description of the government's rationale for introducing amendments updating the due diligence requirements, as stated in the Description section of the Regulatory Impact Analysis Statement accompanying the draft amendments. We have identified apparent inconsistencies between the language in the Regulatory Impact Analysis Statement and the proposed text of S. 57.1(1). The relevant portion of the Description, to which we have added emphasis, is:

[2] Canada Gazette, July 4, 2015, page 1630.

> "An amendment would prescribe the circumstances under which a reporting entity must make a determination that a client is *a domestic politically exposed person or the head of an international organization, or a close associate or family member of such a person*, and the measures to be taken as a result (such as obtaining information on sources of funds and requiring senior management approval to keep an account open). *The prescribed circumstances include account openings* and, where no account exists, very large specified transactions that are deemed to be of higher potential risk, such as lump-sum payments of $100,000 or more for the purchase of life insurance policies or annuities. The Regulations currently contain requirements with respect to politically exposed foreign persons."[3]

The "Small business lens" section of the Regulatory Impact Analysis Statement[4] explains that to assuage concerns from industry with the original proposal (that also would have required determination of close associate status with a PEDP or an HIO on account opening and throughout the relationship), the requirement was re-drafted to require, at account opening, determination of close association with a PEFP only. This has been reflected in the text of amended section 57.1(1) in the case of account openings as well as amended section 57.1(2) in the case of existing accounts. However, determination of close association with a PEDP or an HIO will still be required under certain trigger circumstances (large transactions) or when there are suspicions that the person is a close associate, as reflected in the text of amended section 57.1(3). Despite that this requirement is reserved for limited circumstances, we are still concerned about the cost that will be borne by securities dealers to comply with this requirement.

We have identified what appears to be a discrepancy between the text of the Description and the text of amended section 57.1(1) regarding the scope of the "close associate" test. The underlined text in the Description reproduced above suggests the government's intention is to require in all cases a determination whether the person is a close associate or family member of a PEDP or HIO (in addition to the current requirement to determine close association to PEFPs).

The relevant text of amended section 57.1(1) of the Regulation (to which we have added emphasis) is:

> "…take reasonable measures to determine whether a person for whom they open an account is a politically exposed foreign person, a politically exposed domestic person, a head of an international organization, a family member of one of those persons *or a person who is closely associated with a politically exposed foreign person*."

This section requires that, on account opening, the securities dealer must determine if the person is closely associated with a PEFP only. The Description also suggests that account opening is intended to be a prescribed circumstance requiring broader "close associate" inquiry, and again this is not consistent with the text of section 57.1(1).

Accordingly we request confirmation that, at account opening, in accordance with the text of amended section 57.1(1), securities dealers are required to "take reasonable measures" to determine whether persons opening accounts are "closely associated" with politically exposed foreign persons (PEFP) only.

PEP Determination on an Existing Account

Similarly, in relation to the PEP determination requirements for existing accounts there appears to be a discrepancy between the text of the Description and the text of amended section

[3] *Ibid*., page 1626.
[4] *Ibid*., page 1631.

57.1(2). The Description states[5] that, in the case of existing account holders, the intent is for reporting entities to "periodically determine whether an existing account holder is a PEFP" (and not whether the account holder is a PEDP, HIO or a family member of one of those persons). The text of section 57.1(2)[6] however requires a determination as to whether an existing account holder is a PEFP, PEDP, HIO or a family member of one of those persons, or a close associate of a PEFP.

We request confirmation that the government's intention is as described in the Regulatory Impact Analysis Statement (that the requirement to periodically assess existing account holders is to determine only if they are PEFPs) and, therefore, confirmation that the wording of the proposed amendment to section 57.1(2) is incorrect.

Should the government's intention be that the requirement is in fact to determine if those account holders are PEFPs, PEDPs, HIOs and family members of one of those persons, the investment funds industry believes it will be almost impossible to comply with such a broad requirement given the millions of existing accounts that the industry manages, and compliance efforts will be cost prohibitive for securities dealers.

Just as we have identified in the case of account opening, there also appears to be an inconsistency in the scope of the "close associate" test between the text of the Description and the text of amended section 57.1(2). Whereas the text of section 57.1(2) limits the test to close associates of PEFPs, the text of the Description suggests close association may need to be determined as well with respect to PEDPs, HIOs, and close associates or family members of such persons. Again we request confirmation that, in the case of existing accounts, in accordance with the text of the regulatory amendment securities dealers are required to "take reasonable measures" on a periodic basis to determine whether existing account holders are "closely associated" with PEFPs only.

PEP Determination Where There are Reasonable Grounds to Suspect

Proposed section 57.1(3)[7] states that where a fact is detected that could reasonably be expected to raise reasonable grounds to suspect an existing account holder is a PEFP, PEDP, HIO or a family member *or a close associate of any of those persons*, the entity will take reasonable measures to determine if the account holder is such a person. *[emphasis added]* The "close association" element in section 57.1(3) is inconsistent with the "close association" element in both sections 57.1(1) and (2) since the requirement in section 57.1(3) is not limited to close associates of PEFPs. We request clarification as to whether the government intended in "reasonable grounds to suspect cases" the close association to be determined for PEFPs only (consistent with sections 57.1(1) and (2)) or whether the government intended the test to be as is stated in section 57.1(3). If the intention is the latter, then we reiterate our concerns raised earlier in this letter about the virtual impossibility of compliance with this requirement and, even if compliance could be achieved in theory, the compliance cost on securities dealers would be prohibitive.

[5] Ibid, page 1626.

[6] 57.1(2). Subject to section 62 and subsection 63(5), a securities dealer shall take reasonable measures on a periodic basis to determine whether a person who is an existing account holder is a politically exposed foreign person, a politically exposed domestic person, a head of an international organization, a family member of one of those persons or a person who is closely associated with a politically exposed foreign person.

[7] 57.1.(3) Subject to section 62 and subsection 63(5), if a securities dealer or any of their employees or officers detects a fact that could reasonably be expected to raise reasonable grounds to suspect that a person who is an existing account holder is a politically exposed foreign person, a politically exposed domestic person, a head of an international organization or a family member of, or person who is closely associated with, one of those persons, the securities dealer shall, in accordance with subsection 67.1(3), take reasonable measures to determine whether the account holder is such a person.

Identity Verification

Proposed new section 64(1) states that a person's identity is to be ascertained, in relevant part, by (c) referring to information that is contained in the person's credit file — if that file is located in Canada and has been in existence for at least three years — and by verifying that the name, address and date of birth contained in the credit file are those of the person, or by (d) referring to information from a reliable source that contains their (d)(i) name and address, or (d)(ii) their name and date of birth. We request clarification/examples as to what may be considered a "reliable source", and criteria to differentiate between a credit file and a source of information that is a "reliable source".

Furthermore, we request examples of other sources of information that can be treated as "reliable sources". Based on the text of the proposed new section, please confirm our members' view that they may now rely solely on the credit file in order to meet their customer identification requirements under this section.

Amended sections 64(1)(a), (b) and (c) indicate that a reporting entity may refer to a document or other information about a person, but it must also verify that the name, address and date of birth contained in the document or information are correct information for that person. In the case of government issued identification, would viewing the document (in person) be considered sufficient verification of the information?

Compliance Program

New subsection 71(1)(c)(iii.1) states that, in implementing a compliance program, a person or entity should assess and document, in a manner that is appropriate for the person or entity, the risk referred to in subsection 9.6(2) of the Act, taking into consideration the risks posed by the impacts of any new developments in respect of, or the impact of new technologies on, the person's or entity's clients, business relationships, products or delivery channels or the geographic location of their activities.

New subsection 71(1)(c)(iii.2) also requires an entity to take into consideration any risk resulting from the activities of another entity that is affiliated with it.

Please clarify, and provide examples, as to what is meant in these subsections by "any new developments" and by "risk resulting from the activities of an entity that is affiliated" so that securities dealers will better understand how to identify such risks so that they can be considered and dealt with appropriately in their compliance plans.

General Comments on the Proposals

Coming into Force Provision (Amendment section 95)

It appears there are some unexplained inconsistencies between those provisions which come into force on the day on which [the Regulations are registered (Amendment section 95(1)) and those which come into force 12 months after the day on which the Regulations are registered (Amendment section 95(2)).

For example, pursuant to Amendment section 95(1), Amendment section 30 (relating to Regulation section 54.2) regarding PEP requirements would be in effect on the day on which the Regulations are registered. However, the comparable amendment for securities dealers Amendment section 35 (relating to Regulation section 57.1) comes into force only 12 months after the day on which the Regulations are registered.

We request clarification whether it is the government's intention that these comparable provisions be implemented on different dates.

In addition, the Implementation, Enforcement and Service Standards section[8] of the Regulatory Impact Analysis Statement indicates that measures that will require reporting entities to fulfill new requirements (e.g. with respect to PEDPs and HIOs) would come into force one year after registration of the Regulations. However the Coming into Force provision (Amendment section 95) indicates that the newly added section 67.3 (Reasonable Measures) comes into force on the day on which the Regulations are registered.

We request confirmation that, pursuant to the government's stated intent in the Regulatory Impact Analysis Statement, section 67.3 should be included among the provisions in Amendment section 95(2) that only come into effect 12 months after the day on which the Regulations are registered.

Securities Dealers – Record Keeping for Accounts Kept Open

Proposed new section 23(1)(f) of the Regulation deals with keeping open the account of a person who is determined to be a PEFP, a PEDP, an HIO or a family member of, or a person who is closely associated with, one of those persons *[emphasis added].* This language of the scope of the close associate relationship is inconsistent with that in the amendments to sections 57.1(1) and 57.1(2) where the close association is limited to PEFPs. We request clarification as to whether the narrower scope of the close association (PEFPs only) set out in sections 57.1(1) and 57.1(2) was the intended scope to be included in section 23(1)(f).

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Again we appreciate the opportunity to express our members' concerns and to raise points of clarification on the Proposals. We would be pleased to discuss, at your convenience, any questions or comments you may have on our submission. Please feel free to contact me by email at rhensel@ific.ca or by phone at (416) 309-2314.

Yours sincerely,

THE INVESTMENT FUNDS INSTITUTE OF CANADA

By: Ralf Hensel
General Counsel, Corporate Secretary & Vice President, Policy

[8] Ibid., page 2634.