In the crosshairs — New reporting entities caught by changes to Canada’s anti-money laundering regime

Finance Alert

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On July 10, 2019, Canada’s Department of Finance published comprehensive amendments to the regulations (the “New Regulations”) made under the Proceeds of Crime (Money Laundering) and Terrorist Financing Act (the “Act”). The purpose of the New Regulations is to close loopholes found in the existing regime and to adapt to the commercial realities in an era of e-commerce, FINTECH and digital technology. In June 2020, the New Regulations concerning Cross-Border Currency and Monetary Instruments Reporting Regulations and “virtual currency dealers” are scheduled to take effect; all other regulatory amendments of the New Regulations come into effect in June 2021. This article will focus specifically on the new reporting entities (“REs”) captured under the Act, specifically foreign money service businesses, the life insurance sector and dealers in virtual currency.

Foreign money service businesses

Currently under the Act, the definition “Money Services Businesses” ("MSBs") does not distinguish between domestic and foreign money services businesses.
The New Regulations create two separate definitions: one for domestic MSBs and one for foreign MSBs. In fact, the Act was amended in 2014 to add the definition of foreign MSBs, but that amendment will not come into effect until the New Regulations relating to foreign MSBs do, namely in June 2021. The New Regulations amend the definition of MSBs to only include domestic MSBs by inserting the language “entities that have a place of business in Canada.”

The definition of MSB under the current regulations is:

persons and entities engaged in the business of foreign exchange dealing, of remitting funds or transmitting funds by any means or through any person, entity or electronic funds transfer network, or of issuing or redeeming money orders, traveller’s cheques or other similar negotiable instruments except for cheques payable to a named person or entity.

The definition of a domestic MSB under the New Regulations will be:

persons and entities that have a place of business in Canada and that are engaged in the business of providing at least one of the following services:

(i) foreign exchange dealing;

(ii) remitting funds or transmitting funds by any means or through any person, entity or electronic funds transfer network;

(iii) issuing or redeeming money orders, traveller’s cheques or other similar negotiable instruments except for cheques payable to a named person or entity;

(iv) dealing in virtual currencies, or

(v) any prescribed service.

The definition of a foreign MSB under the New Regulations will be:

persons and entities that do not have a place of business in Canada, that are engaged in the business of providing at least one of the following services that is directed at persons or entities in Canada, and that provide those services to their clients in Canada:

(i) foreign exchange dealing;

(ii) remitting funds or transmitting funds by any means or through any person, entity or electronic funds transfer network;

(iii) issuing or redeeming money orders, traveller’s cheques or other similar negotiable instruments except for cheques payable to a named person or entity.

(iv) dealing in virtual currencies, or

(v) any prescribed service.

Under the current definition, it has been the position of some non-resident entities that, while they may have been engaged in the activities enumerated in the subparagraphs (i)-(iii), they were not in the business of doing so in Canada, and were therefore not caught by the definition. Given that cases under these provisions of the Act rarely make their way to the court, and due to existing persuasive legal precedent, Parliament therefore decided to add the definition of foreign MSB to close the gap on non-residents who transact money services business with Canadians from outside of Canada.

Under the New Regulations, foreign money services businesses will have the same obligations as domestic businesses when they provide at least one of the listed services which are directed at and provided to clients located in Canada. According to FINTRAC, the new definitions are designed to level the playing field between domestic and foreign MSBs, the latter now being required to fulfill the same obligations as the former for the same activities (e.g. register with FINTRAC, exercise customer due diligence, report transactions, and keep records).
In addition, Canadian financial entities are prohibited from opening or maintaining an account for, or having a correspondent banking relationship with, an unregistered foreign MSB (s. 9.3(1) of the Act). Furthermore, the New Regulations provide that a foreign MSB’s registration is revoked if, after having been issued an administrative monetary penalty for non-compliance, it fails to pay the penalty associated with it, thus making it ineligible to do business with Canadians.

**Potential issues arising from the new definitions for MSB: the meaning of “direct”**

In order to fall under the definition of a foreign MSB, an MSB must “direct” its services to persons in Canada. It is an open question as to how the term “direct” will be interpreted by FINTRAC. For example, the meaning of “direct” could involve advertising on social media platforms or on broadcast television. FINTRAC is expected to provide further information on activities and platforms that in its view will be captured by the term “direct.” One wonders why Parliament did not opt for the more obvious terms “advertise,” “solicit” or “promote” to identify the targeted conduct, which arguably would have had more certainty in terms of activities caught by the New Regulations. At a minimum, the requirement that foreign MSBs must be “directing” their services to Canadians will set the bar higher than simply having a Canadian bank account, which FINTRAC has previously asserted is sufficient to give it jurisdiction over such non-resident foreign MSBs.

**The life insurance sector**

Prior to the New Regulations, the life insurance sector was not subject to the same obligations as other REs under the Act, even when it engaged in similar activities. The New Regulations specify that where the life insurance sector is engaged in mortgages, loans, and other activities similar to those undertaken by REs, they are now subject to the same obligations under the Act. Accordingly, life insurance companies captured by the New Regulation will need to implement new processes and procedures in order to fulfill their obligations under the Act.

It is to be noted that the New Regulations exclude non-collateralized loans, as well as low-risk collateralized loans (i.e. loans secured by the value of an insurance policy), including those issued for the sole purpose of funding treatment of a terminal illness or the purchase of a life insurance policy.

Under the New Regulations a financial entity in the life insurance sector is defined as:

(c) a life insurance company, or an entity that is a life insurance broker or agent, in respect of loans or prepaid payment products that it offers to the public and accounts that it maintains with respect to those loans or prepaid payment products, other than

(i) loans that are made by the insurer to a policy holder if the insured person has a terminal illness that significantly reduces their life expectancy and the loan is secured by the value of an insurance policy;

(ii) loans that are made by the insurer to the policy holder for the sole purpose of funding the life insurance policy; and

(iii) advance payments to which the policy holder is entitled that are made to them by the insurer.

**Dealers in virtual currency**

The New Regulations create new obligations for dealers in virtual currency that offer services to Canadian clients. This category will likely capture online trading platforms, exchanges and other intermediaries which engage in virtual currency transactions.

Under the New Regulations virtual currency is defined as:

(a) a digital representation of value that can be used for payment or investment purposes that is not a fiat currency and that can be readily exchanged for funds or for another virtual currency that can be readily exchanged for funds; or

(b) a private key of a cryptographic system that enables a person or entity to have access to a digital representation of value referred to in paragraph (a).
Additional definitions of importance include:

_fiat currency_ - a currency that is issued by a country and is designated as legal tender in that country, and

_funds_ - (a) cash and other fiat currencies, and securities, negotiable instruments or other financial instruments that indicate a title or right to or interest in them; or (b) a private key of a cryptographic system that enables a person or entity to have access to a fiat currency other than cash.

Money services businesses will include domestic and foreign businesses that are “dealing in virtual currency.” The “dealing in” activities include virtual currency exchange services and value transfer services. As is required of all MSBs, persons and entities dealing in virtual currencies will also need to fulfill all obligations, including implementing a full compliance program and registering with FINTRAC. In addition, any reporting entity in any sector that receives $10,000 or more in virtual currency (e.g. receiving deposits or any form of payment) would have record keeping, identification and reporting obligations.

The goal of the New Regulations with respect to virtual currency dealers is to mitigate the money laundering and terrorist activity financing vulnerabilities of virtual currency, while not unduly hindering innovation. FINTRAC thus stated that “the amendments are targeted at persons or entities engaged in the business of dealing in virtual currencies, and not virtual currencies themselves”

This article is part of a series discussing the changes to Canada’s anti-money laundering regime. You may read the first article in the series here. Please check back for our upcoming article which will provide an overview of new record keeping requirements under the Act, including: virtual currency transaction records, prepaid product accounts records and updates to the amount of information an RE must record.

This article provides only general information about legal issues and developments, and is not intended to provide specific legal advice. Please see our disclaimer for more details.

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