



## **CREDIT UNION CENTRAL OF CANADA**

**Submission to the House of Commons Standing Committee on Finance in regard to  
Bill C-25: *An Act to amend the Proceeds of Crime (Money Laundering) and Terrorist  
Financing Act and the Income Tax Act and to make a consequential amendment to  
another Act.***

**NOVEMBER 4, 2006**

Credit Union Central of Canada (Canadian Central) is writing to provide the House of Commons Standing Committee on Finance with a credit union system perspective on the Federal Government's proposed legislation – Bill C-25, *An Act to amend the Proceeds of Crime (Money Laundering) and Terrorist Financing Act and the Income Tax Act and to make a consequential amendment to another Act*.

Canadian Central is the national trade association for credit unions in Canada outside of Quebec. Through their ownership of Canadian Central, our 9 provincial credit union central members are able to provide their direct credit union members with national services that include the last tier of system liquidity, participation in the clearing and settlement of payment items through the Canadian Payments Association, participation in the INTERAC debit network and government relations.

The Canadian Central family of credit unions numbers 506, with nearly 1,800 locations and assets of approximately \$91 billion. Together, they serve nearly 4.9 million members, and employ over 20,000 people. Altogether, these credit unions serve 951 communities across Canada. In 330 smaller towns, credit unions are the only financial institution.

The credit union system is committed to helping the Federal Government and law enforcement agencies combat money laundering and terrorist financing. We recognize the broad dangers that money laundering and terrorist financing represent to Canadians in general, but we are also well aware of the operational and reputation risks that money laundering and terrorist financing present to credit unions and other financial institutions.

It is with this in mind that we respectfully outline our comments and concerns regarding the evolution of Canada's anti-money laundering (AML) and anti-terrorist financing (ATF) regime as exhibited in the legislative proposals contained in Bill C-25. This submission will proceed by outlining four broad concerns about the manner and direction in which Canada's anti-money laundering and anti-terrorist financing regime is evolving

and then it will set out a number of specific comments about the legislative proposals outlined in Bill C-25.

1. **Canadian Central is concerned that the full impact of Bill C-25 on credit unions cannot be properly assessed at this time since the Bill, on its own, presents an incomplete picture of the Federal Government's efforts to elaborate its approach to AML-ATF activities.** Thus the Bill introduces significant new concepts in very "high level" language<sup>27</sup>, with the details to be worked out in the future and introduced through the release of new regulations over the coming months. It is our understanding that the legislation will be significantly fleshed out by four sets of regulations, however, these regulations will not be subject to Parliamentary review.
2. **Canadian Central is concerned that Bill C-25 is being rushed through the Parliamentary process** with little time to assess a) whether the new additional regulatory requirements are in fact needed to address money laundering and terrorist financing in Canada; b) whether the proposed measures will be effective in preventing money laundering and terrorist financing rather than merely producing more and more transaction reports; and c) whether the requirements are fair in terms of the distribution of compliance costs across society. To date, the Federal Government has not presented compelling evidence to stakeholders that the measures proposed are needed, effective and fair thus it is even more important that Parliament take the time required to scrutinize Bill C-25 in a careful manner.
3. **In the absence of compelling evidence of need, Canadian Central is concerned that the proposed legislation is largely driven by the perceived need to make Canada's AML-ATF regime formally consistent with new international Financial Action Task Force (FATF) standards rather than in response to any substantive threat** arising from loopholes in Canada's current AML-ATF regime.
4. **Canadian Central is concerned about the significant regulatory burden that many of the proposals found in Bill C-25 will entail for credit union operations.** Credit unions are relatively small financial institutions when compared to large Canadian chartered banks and the additional regulatory requirements proposed in C-25 present a challenge because the resources and personnel available to respond at the credit union level are limited. Concerns about this regulatory and cost burden on credit unions are magnified in light of the seemingly limited effectiveness of the current AML-ATF transaction reporting regime. Thus we have noted, with concern, the observation in the 2004 Report of the Auditor General that in 2003-2004, out of nearly 10 million transaction

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<sup>27</sup> . For example, the Bill introduces the concept of an attempted suspicious transaction however; it provides little guidance as to how to identify such transactions or how the reporting of such transactions is to be carried out.

reports filed with FINTRAC, only 197 disclosures were made by FINTRAC to law enforcement and other agencies. Equally troubling is the observation that – at the time of the audit – no prosecutions had been launched as a result of those FINTRAC disclosures. More recently, in the 2005-2006 year, FINTRAC reported only 168 disclosures to law enforcement and other agencies despite the fact they received 14, 974, 454 reports from regulated entities in that same period. It is also disturbing that after six years of operation, FINTRAC does not clearly state how many of its disclosures have helped in successful prosecutions.<sup>28</sup>

In a recent academic article evaluating the effectiveness of similar AML-ATF policies in the United Kingdom, Professor Jackie Harvey effectively summarized the concerns outlined above:

Underlying any research in [the area of money laundering] is the fundamental lack of convincing empirical evidence on the extent of money laundering that is actually occurring...and the associated problem of being able to determine the effectiveness of countermeasures advocated by the regulatory bodies to deal with the phenomenon,. In consequence, a second best input approach has developed in which compliance with systems and procedures become preminent. Firms seek to demonstrate compliance with their domestic regulators by increasing the number of suspicious activity reports and national governments seek to demonstrate compliance with international bodies by increasing the scope of its laws and regulations. However, demonstration of compliance provides no information about the impact of regulation on the amount of money laundering activity or about reducing predicate crime....

The concern remains, however, that concentration on compliance implies the fact that we continue to look under the wrong stones in our search to reduce money laundering activity, and at considerable cost. It is argued that the machinery of compliance has become self-generating with increasing cost implications for the financial sector.<sup>29</sup>

Having set out our four broad concerns, Canadian Central's comments and recommendations in regard to specific legislative proposals found in Bill C-25 are

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<sup>28</sup> FINTRAC's 2006 Annual Report states that in 2005-2006 FINTRAC made 168 case disclosures to authorities with an aggregate value of those disclosures being approximately \$5 billion. The report also states that FINTRAC's "...contributions are being reflected more and more in investigations, prosecutions and charges." However, the report provides no evidence that these disclosures have helped authorities with successful prosecutions. This lack of evidence of success in translating disclosures into successful prosecutions was a key criticism of Canada's AML-ATF regime in found in the Auditor General's Report of 2004. See *FINTRAC Annual Report, 2006* and *2004 Report of the Auditor General of Canada*.

<sup>29</sup> Harvey, Jackie (2005) An Evaluation of Money Laundering Policies. *Journal of Money Laundering Control* (Vol. 8, No. 4) p. 339.

outlined below. Many of these comments will also elaborate on the concerns outlined above.

### **Re. “Attempted Suspicious Transactions”**

Currently, reporting entities, including credit unions, are required to file suspicious transaction reports on financial transactions that have been completed. However, Bill C-25, if enacted, will require reporting entities to also file with FINTRAC reports of suspicious transactions that have been unsuccessfully “attempted”.

This proposal is a concern because the Bill provides little guidance as to how to identify incomplete suspicious transactions and thus may be introducing a compliance requirement that will be difficult to meet in a satisfactory manner. In addition, if a transaction is attempted, but then abandoned, it may be difficult, if not impossible, to obtain the information necessary to file the required report. With the introduction of an Administrative and Monetary penalties regime (see below), compliance difficulties may be translated into fines and penalties. **With this in mind, we recommend that if the Federal Government is to proceed with this legislative proposal they should come forward with detailed and realistic guidance for determining when and how to report such transactions before this aspect of the Bill comes into force.**

From an operational perspective, the immediate impact of such a requirement on credit unions will be the need to devote additional resources to changing their policies and suspicious transaction reporting procedures, and additional staff training. It is also likely that tracking technology will have to be upgraded. This could be a particularly onerous burden on credit unions, particularly the smaller units. This proposal could also lead to demands upon provincial centrals to take over some reporting functions although some provincial centrals are not currently set up to take on this responsibility.

### **Re. Risk Based Approach/Non Face to Face Transactions**

It is our understanding that Bill C-25 provides that any reporting entity’s anti-money laundering program must include policies and procedures that allow them to assess the

risk of money laundering or terrorist financing in the course of their activities. The higher the assessed risk, the more sophisticated the measures for client identification, monitoring and record keeping must be.

Once again, we are concerned that there is not enough detail in the proposed legislation for us to intelligently comment on how this new requirement may impact credit unions. What a “risk based approach” really looks like, and the precise obligations for high risk situations, will be set out in the regulations.

Notwithstanding the tentative nature of our analysis on this point, we can at least reasonably speculate that each credit union will be required to assess each financial product it offers on a case by case basis for its associated risk of money laundering and terrorist financing. For some smaller credit unions this could be a very challenging task. Once again, provincial centrals may be called upon to provide more assistance and guidance to such credit unions.

### **Re. Politically Exposed Persons**

Bill C-25 will require reporting entities, in certain circumstances, to be identified in the regulations, to make a formal determination if they are dealing with a “politically exposed foreign person” (a “PEP”), or a “prescribed family member” of a PEP. Once a positive determination has been made, the reporting entity must obtain senior management approval (in prescribed circumstances) and take other measures that may be set out in the regulations.

A “PEP” is defined in the legislation to include the following:

- head of state or government;
- member of the executive council of government or member of legislature;
- deputy minister or equivalent rank;
- ambassador or attaché or counselor of an ambassador;
- military officer with a rank of general or above;
- president of a state owned company or state owned bank;
- leader or president of a political party represented in the legislature;
- head of a government agency;
- judge;

- holder of any other office or position set out in the regulations.

In our opinion, if this requirement comes into force, credit unions will face an administratively onerous requirement to make inquiries as to the status or particulars of the occupation of a person conducting a transaction, and his or her family members. In addition, credit unions will be compelled to modify their existing policies and procedures, including account opening documentation and other documentation to ensure that PEPs are identified and PEP files are addressed by senior management where required.

A very important concern about this proposal is the lack of any “materiality threshold” for triggering this relatively onerous requirement. Transactions, large or small, appear to trigger this requirement. **Canadian Central recommends that if the Federal Government is to proceed with this proposal it should proceed with developing a “materiality threshold” that would distinguish between PEP transactions of significance and those of little concern in relation to money laundering or terrorist financing.**

#### **Re. Administrative and Monetary Penalties (AMPs)**

Bill C-25 introduces a new concept under the title “violation”. A “violation” is a contravention of the Act that will be designated as a violation under the regulations. A series of penalties less punitive than the fines available under the current Act for “offences” are then assigned to these “violations”. In the Bill, the penalty “shall, in each case, be determined taking into account that penalties have as their purpose to ensure compliance with this Act rather than to punish.....”

The Bill also allows FINTRAC to offer reduced penalties where violators agree to enter into a compliance agreement with FINTRAC. These changes are aimed at giving FINTRAC greater flexibility to promote compliance, through a broader range of non-criminal sanctions and a graduated penalty scale.

These proposals are of concern to Canadian Central because an AMP framework is only workable and fair in situations when there are clear and precise compliance requirements

and the responsibilities of parties are not open to interpretation. However, as noted in the preceding (e.g. in regard to the concept of a “suspicious attempted transaction”), these circumstances are not met and this situation could result in parties being liable for penalties for violations that are not clear on their face.

### **Re. Electronic Funds Transfer (EFT)**

In the case of a “prescribed electronic funds transfer” (possibly a transfer of \$10,000 or more), the Bill requires a reporting entity to:

- include the name, address, account number (or other reference number) of the client who requested the funds transfer (along with any other information which may be set out in the regulations).
- take reasonable measures to ensure that any transfer that the person or entity receives includes the above information; and
- take other measures as may be set out in the regulations.

This change would likely require credit unions to implement banking system changes. For example, additional information will be required to be forwarded with every prescribed EFT and, on any incoming EFTs, reporting entities will have to take “reasonable measures” to obtain the same type of information. This requirement may be difficult to fulfill for EFT transactions between unaffiliated entities.

To conclude this brief submission, Credit Union Central of Canada wishes to express its appreciation for the opportunity to provide comments to the House of Commons Standing Committee on Finance in regard to their review of Bill C-25: *An Act to amend the Proceeds of Crime (Money Laundering) and Terrorist Financing Act and the Income Tax Act and to make a consequential amendment to another Act.*