



**Submission in Response to Finance Canada's Concept  
Paper on Identifying and Monitoring Politically  
Exposed Persons Under Canada's Anti-Money  
Laundering and Anti-Terrorist Financing Regime**

**CREDIT UNION CENTRAL OF CANADA**

- March 2006 -

Credit Union Central of Canada (Canadian Central) is writing in response to Finance Canada's discussion document concerning the treatment of "Politically Exposed Persons" (PEPs) under Canada's anti-money laundering and anti-terrorist financing (AML/ATF) regime. It is our understanding that the proposals contained in the concept paper will, in some manner, help form the basis of new anti-money laundering and anti-terrorist financing measures prescribed through legislation, regulations and/or guidelines.

Canadian Central appreciates this opportunity to provide feedback on the proposals contained in the concept paper and hope our comments are of assistance to the work of the Department of Finance. The credit union system is committed to helping the Federal Government and law enforcement agencies combat money laundering and terrorist financing. We recognize the 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.

The Department of Finance has requested that stakeholders focus their comments on the substance of the proposals, how they might "fit" with existing business practices and the challenges they may represent from an operational perspective. However, the proposals contained in the concept paper have generated considerable feedback from within the credit union system with many comments raising broad concerns about the overall approach to PEPs and – in some respects – the general approach taken in developing Canada's AML/ATF regime. Canadian Central is of the view that these comments merit consideration by the Department of Finance.

More specifically, our system views the proposals set out in the PEP document as a signal that the Government of Canada is planning to widen the scope of the application of AML/ATF legislation and regulation and, in so doing, impose further compliance requirements on reporting entities such as credit unions. The prospect of further compliance requirements in regards to PEPs is of concern because the PEP proposals:

1. Do not appear to respond a clearly identified need;
2. Lack an accompanying analysis regarding the anticipated effectiveness of the proposed measures;
3. Do not indicate that they are the result of a considered analysis that balances the PEP proposals with other public policy objects (e.g. productivity growth, maintaining privacy and constitutional rights);
4. Do not appear to be the result of a cost-benefit analysis carried out that demonstrates the public and private sector costs of introducing these proposed reforms are outweighed by the benefits that will accrue in terms of the detection and deterrence of money laundering and terrorist financing.

Each of these concerns will be elaborated in further detail in the first four sections below. Section 5 will outline very specific concerns about the substance of the proposals outlined in the concept paper. Section 6 will make recommendations that hopefully will be of value to the Federal Government as proceeds to legislation.

## **1. EVIDENCE OF NEED**

The Government of Canada has not yet presented evidence that, in the Canadian context, PEPs present any greater money laundering/terrorist financing risk than non-PEPs. Canadian Central is of the view that when considering whether to regulate in this area the Government of Canada needs to assess whether the PEP proposals respond to a genuine need in the Canadian context. This consideration also conforms to requirements set out under the Federal Government's Smart Regulation Initiative. In fact, a recent Smart Regulation document<sup>1</sup> states that when preparing regulatory proposal the first two basic analytical questions that need to be answered are:

1. What is the nature, magnitude and evolution of the public policy issue?
2. Is federal government action needed?

To date, the Government of Canada has not presented compelling evidence that PEPs present a problem in Canada and that Federal Government action is needed in this area. Canadian Central is of the view that such evidence, if available, would be helpful in alleviating stakeholder concerns that the proposed PEP regulations are unnecessary.

## **2. EVIDENCE OF EFFECTIVENESS**

The legislative and regulatory proposals contained in the PEP concept paper are not accompanied by any analysis that indicates the proposed measures will be effective in detecting and deterring money laundering or terrorist financing associated with PEPs. It is unclear whether the proposals contained in the document reflect the experience of other jurisdictions and have been proven effective in other contexts.

Concerns about the effectiveness of the PEP proposals are magnified in light of questions raised about the general effectiveness of Canada's AML/ATF regime. Thus, credit unions have noted with concern, the observation in the 2004 Report of the Auditor General that in 2003-2004, that out of nearly 10 million transaction reports filed with FINTRAC, only 197 disclosures were made by FINTRAC to law enforcement and other agencies. Equally troubling is the observation that –

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<sup>1</sup> Government of Canada, *Understanding the Government Directive on Regulating*. (November 2005), p. 2.

at the time of the audit – no prosecutions had been *launched* as a result of those FINTRAC disclosures<sup>2</sup>.

The November 2004 EKOS evaluation of AML/ATF initiatives<sup>3</sup> is somewhat more positive but does not allay these concerns as the EKOS analysis measures the success of the initiatives in a formalistic manner with a part of the evaluation of success focusing on whether the AML/ATF regime has been implemented, whether Canada is meeting international standards and whether the regime strikes an appropriate balance with privacy/Charter concerns<sup>4</sup>. However, the EKOS report offers very little detailed evidence that the initiatives are being effective in achieving their stated goal of detecting and deterring money laundering and terrorist financing<sup>5</sup>.

### **3. BALANCING PUBLIC POLICY OBJECTIVES**

The legislative and regulatory proposals contained in the PEP concept paper raise further concerns as it is not apparent that the Government of Canada has considered how the proposals will impact other public policy objectives (e.g. productivity growth<sup>6</sup> and the protections offered by the Charter of Rights and Freedoms).

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<sup>2</sup>. Auditor General of Canada, “Chapter Two: Implementation of the National Initiative to Combat Money Laundering”, 2004 *Report of the Auditor General of Canada*, Sections 2.21 and Section 2.22. Canadian Central recognizes, however, that FINTRAC disclosures may have assisted in on-going investigations.

<sup>3</sup>. EKOS. *Year Five Evaluation of the National Initiatives to Combat Money Laundering and Interim Evaluation of Measures to Combat Terrorist Financing: Final Report*. (November 2004).

<sup>4</sup> The EKOS document positively assesses the balance between the AML/ATF initiatives and privacy/Charter rights, however, the document does not indicate that the EKOS assessment involved consultations with Canadian Privacy Commissioners, consumer groups or civil liberties organizations. In fact, the analysis only clearly indicates that law enforcement and national security organizations were consulted in this regard. On this see also A. Michael Andrews. *Submission in Response to Finance Canada’s Enhancing Canada’s Anti-Money Laundering and Anti-Terrorist Financing Regime Consultation* (August 2005) p. 2.

<sup>5</sup> The EKOS document points to the 197 disclosures as evidence the AML/ATF initiatives are working whereas the Auditor General’s report places the figure in context of the 10 million yearly transaction reports and interprets the effectiveness of the initiatives in a more negative light. Admittedly, the EKOS outlines some anecdotal instances where FINTRAC disclosures may have assisted in the prosecution of individuals and seizure of assets.

<sup>6</sup> In recent years the Federal Government has demonstrated a stronger interest in measures to boost productivity growth in Canada. For example, in the 2005 *Economic and Fiscal Update* then Finance Minister Ralph Goodale outlined an economic plan aimed at increasing productivity Canada. Canadian Central is of the view that if the productivity agenda is to advance the Government of Canada must consider how all of its regulatory endeavours impact productivity growth in Canada and weigh those impacts against other policy goals. This approach would be particular welcome in regard to AML/ATF measures.

The PEP proposals may raise specific issues in regard to rights and freedoms as they require reporting entities to subject particular individuals to special scrutiny and reporting on the basis of their employment status. Furthermore, this is a particular concern for the credit union system as it will require that a credit union treat members of a cooperative and democratic organization differently although there may be no substantive justification for doing so.

An earlier submission to Finance Canada by the Office of the Privacy Commissioner of Canada commented on the PEP proposals stating that:

The notion that people will be subjected to extra scrutiny, not because of suspicion, but simply because of their position is alarming. In many cases, this scrutiny would be in addition to the security checks and other screening that would have taken place prior to their appointments.

We have a great deal of difficulty accepting the need for this provision. If this proposal goes forward, the scope of this provision must be as narrow as possible<sup>7</sup>.

Canadian Central agrees with the concerns expressed by the Office of the Privacy Commissioner and holds the view that it would be appropriate for the Government of Canada to subject the PEP proposals to a legal review in order to be certain that they are in accordance with Charter protections and can withstand a Charter challenge. If such a review has taken place then the results should be communicated to stakeholders to assure them that the PEP proposals will not be subject to question after they have been implemented.

#### **4. ASSESSMENTS OF COSTS AND BENEFITS**

Finally, it is not clear that the legislative and regulatory proposals contained in the PEP concept paper have been assessed from a cost/benefit and practicality perspective. This has been, and remains, a concern in regard to many of the AML/ATF proposals currently under consideration by the Government of Canada.

In regard to the PEP proposals, this shortcoming is not surprising since an adequate cost-benefit analysis would require a previous analysis of the actual need for measures to deal with PEPs and an assessment of whether the proposed PEP measures would be effective in dealing with the problem identified. A cost-benefit analysis would also have to question whether the PEP requirements actually add anything to the current regime in addressing such a problem, if indeed it does exist. It may in fact be the case that existing requirements for customer due diligence and reporting of suspicious transactions will be as effective in detecting the laundering of proceeds of corruption as they are in detecting the laundering of the proceeds of other crimes.

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<sup>7</sup> Office of the Privacy Commissioner. *Submission in Response to Finance Canada's Enhancing Canada's Anti-Money Laundering and Anti-Terrorist Financing Regime consultation* (September 2005). p. 4.

It is also unclear whether the Government of Canada has assessed the proposals from a practical point of view as it will require financial institutions to track potentially thousands if not millions of Canadians over time<sup>8</sup>. At the same time, reporting entities will likely be expected to conduct follow-up investigations of all customers to determine if they, or a relative, or an associate, have in the interim become a PEP.

## **5. CONCERNS ABOUT SPECIFIC PEP PROPOSALS**

### **5A) DEFINITION OF PEPS**

Canadian Central appreciates the fact that the proposed definitions for PEPs has been narrowed somewhat to apply to individuals in a prescribed position *at the national level*. However, the definition of PEPs still appears very broad given that it will apply to such individuals and their immediate families if they *ever* held such positions in *any* nation/country. As indicated in footnote 8, such a broad definition could lead to situations where increased scrutiny is required for individuals that pose little or no risk from an AML/ATF perspective. Furthermore, the list of family members still appears quite wide.

Canadian Central is of the view that the definition of a PEP should be narrowed to focus on officials holding or having held official positions in jurisdictions identified as “at risk” for official corruption. These jurisdictions could be identified according to criteria established by the Federal Government or by an international organization<sup>9</sup> mandated to do so. Furthermore, the Federal Government could regularly provide a list of identified PEPs from such jurisdictions that would be regularly scanned by regulated entities and compared against their account records.

### **5B) ACCOUNT OPENING/ONGOING BUSINESS RELATIONSHIPS**

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<sup>8</sup> . The figures could be very high indeed given that the concept paper indicates in the first line that the proposals would apply to “[A]ny person who **ever** had one of the following positions at the national level in **any** country /nation...” and then proceeds to enumerate 10 categories of PEPs and include their immediate family members. It is conceivable that these proposals would capture an individual who was a judge in Sweden in the 1970s who subsequently moved to Canada and has been retired for 25 years. Alternatively, it may capture an individual that acted as an interim CEO for a year at the International Development Research Centre (a Canadian crown corporation) in 1983 and has subsequently worked in the private sector. The proposals would also capture their family members.

<sup>9</sup> Transparency International (TI) is an example of an international non-governmental organization that is devoted to combating corruption. TI has an International Secretariat in Berlin and 99 independent National Chapters around the world and works at the international and national levels to curb corrupt practices. TI produces a yearly report on corruption rankings that rates jurisdictions on levels of corruption. Such a ranking could possibly be the basis for the identification of “at risk” jurisdictions. See, for example, the *Transparency International Corruption Perceptions Index 2005* available at [http://www.transparency.org/news\\_room/in\\_focus/2005/cpi\\_2005](http://www.transparency.org/news_room/in_focus/2005/cpi_2005).

In section B. (2) it is proposed that, at account opening, or at the beginning of a business relationship, reporting entities must ask 4 or 5 questions provided by Finance Canada or FINTRAC to determine if the customer is a PEP or not.

On a conceptual level it is difficult to imagine questions that could effectively be asked of all new credit union members. For example, would questions that make sense for an older foreign national equally apply to their 10 year grandchild, born and raised in Canada, and opening a basic savings account? The young individual may not adequately understand the questions, more importantly, if the questions are such that they do not make sense in the context they are being asked it becomes difficult to maintain “buy in” from front line staff.

Given the likely difficulties associated with developing appropriate questions, Canadian Central would welcome the opportunity to review and comment on the questions as they are being developed.

A number of credit union respondents have asked for further detail in regard to the account opening questions. For example:

- Are the answers to the questions to be provided in a written form and signed by the respondent?
- Will the responses to these questions get filed with the Department of Finance or FINTRAC?
- What is a credit union to do if an individual refuses to provide the requested information? Does the credit union record and report the refusal or are they obligated to refuse service to the individual<sup>10</sup>?
- Is it contemplated that there will be liability or penalties levied against any regulated entity that should happen to miss collecting this information? If so, what are those penalties expected to be?

In section “B. (2) Steps” it is proposed that once the business relationship is approved, reporting entities perform enhanced ongoing monitoring. Their level of scrutiny should be particularly high when:

- the client comes from a country with a high level of crime and corruption
- unusual activities for the client are carried out.
- unusually high volume of [incoming] international wire transfers are initiated by the client.

The proposals calling for enhanced ongoing monitoring raise a number of concerns. First, the proposed requirements introduce a further element of

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<sup>10</sup> The requirement that a regulated entity regularly assess whether they will continue to operate a PEP account appears to deviate from current policy and practice which requires reporting of suspicious transactions but not the cessation of dealings. This proposed change is a concern as it raises the possibility that a senior management judgment to continue the operation of a PEP account may be second guessed by authorities and invite criminal or administrative liabilities. With this associated risk it raises the question as to why a credit union open an account for a PEP at all.

judgment by staff without creating standards by which those judgments are to be made. For example, in the absence of an official list of countries with “a high level of crime and corruption” credit union staff will be called on to make educated, or worse, uneducated guesses. The same is true in regard to determining what is “unusual activity” or an “unusually high volume” of wire transfers.

Canadian Central recommends that if the Government of Canada chooses to go forward with such requirements they provide guidance to regulated entities to assist in assessing account activities associated with PEPs.

## **6. RECOMMENDATIONS**

1. The Government of Canada should carry out a risk assessment that would examine whether PEPs in Canada present an extraordinary risk for money laundering and terrorist financing activities. The results of the risk assessment should be shared with stakeholders.
2. The Department of Finance should carry out an assessment as to whether the proposals set out in the concept paper can be expected to be effective if implemented. The results of the assessment should be shared with stakeholders.
3. The Government of Canada or Department of Finance should carry out a legal review of the proposals to determine whether they conform to the protections offered by the Canadian Charter of Rights and Freedoms. The results of the legal review should be shared with stakeholders.
4. The Department of Finance should carry out a cost-benefit analysis assessing whether, in light of the risk posed by PEPs and the expected effectiveness of proposed measures, it is worthwhile to proceed with the PEP proposals.
5. If the Government of Canada chooses to proceed with the PEP proposals, Canadian Central recommends that the definition of a PEP be narrowed to focus on officials holding or having held official positions in jurisdictions identified as “at risk” for official corruption. These jurisdictions could be identified according to criteria established by the Federal Government or by an international organization mandated to do so. The definition of a PEP should also be narrowed in terms of time horizons as it is unreasonable to track individuals who have – at any time in their career - held such positions.
6. The Federal Government should provide regulated entities with a list of identified PEPs from “at risk” jurisdictions that would be regularly scanned by regulated entities and compared against their account records.

7. The Department of Finance should provide stakeholders with the opportunity to review and comment on the proposed questions that would be asked at account opening.
8. The Department of Finance should provide guidance as to what a regulated entity should do if an individual refuses to provide answers to questions that seek to identify whether the individual is a PEP.
9. Canadian Central recommends that if the Department of Finance chooses to go forward with the PEP proposals it provide comprehensive guidance as to how PEP account activity should be monitored.

To conclude this submission, Credit Union Central of Canada wishes to express its appreciation for the opportunity to provide comments on the PEP concept paper. Please feel free to contact Rob Martin, Senior Policy Advisor in the Government Relations Department at Credit Union Central of Canada (613-238-6747 ext. 327) if you have any further questions.

Sincerely

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