

Remarks by Nicholas Le Pan, Superintendent,
Office of the Superintendent of Financial Institutions, Canada (OSFI)
at the

OSFI AML / ATF Information Session

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Thank you for coming here today and attending what is a very important session on anti-money laundering and anti-terrorism funding. It is good to see so many of you here as we discuss a subject of so much interest, and concern, to financial regulators, law enforcement officials, and financial institutions.

Some have asked, why the concern? Why are OSFI and other groups spending so much time and resources on the AML/ATF issue?

The short answer is that AML/ATF is very important. In Canada we have seen some good and some not so good reaction to AML/ATF requirements. Some institutions have seen the importance of addressing AML/ATF issues and are working hard to implement or improve their systems. And there are others that have hesitated or have stated they have reservations about complying with requirements on this matter. That is not satisfactory.

OSFI has identified and communicated a number of areas needing improvement to the industry. I have very low tolerance for slippage in this area. Good progress has been made but more needs to be done.”

The bar is constantly being raised and this issue will not disappear, it won't just go away. I also know it's not easy, and it's costly, and we need to continue to focus.

There are many reasons why banks, insurers, securities firms, regulators and enforcement bodies in Canada have to be interested in AML/ATF issues.

Security of Canada's financial system

Canada has a world-class financial system. It is very important for our reputation as a country, and for the reputation of our financial institutions, that we do as much as we can to keep organized crime from abusing our financial system. Criminals tend to launder funds where standards are lax – they will attack the weakest link. As Canadians we have to make sure that our financial system is doing a very good job to deter and detect money laundering and terrorism financing.

Money laundering is a potential threat to Canada's financial system and its security, stability, safety, and reputation. It is a threat to security, because money laundering is linked to organized crime. It is a threat to the safety of the financial system, because

banks that are associated with money laundering, knowingly or unknowingly, will suffer damage to their reputation, and that reputational loss can lead to a loss of business. In extreme cases some institutions in other countries have had to be closed or sold, because of material AML / ATF deficiencies that lead to major loss of reputation.

Worldwide focus on AML/ATF issues

The world's governments, including Canada, are committed to the fight against terrorism, including the financing of terrorism. You are all familiar with the actions taken by the United Nations to freeze terrorists funds. The UN Office on Drugs and Crime also funds AML training as part of its mission to fight illicit drugs and crime. The work of the FATF-style regional bodies is also expanding, particularly in Africa and the Middle East. Today, there are some 150 jurisdictions that are FATF members or members of FATF-style regional bodies and that subscribe to FATF standards. There are over 50 jurisdictions that have not fully subscribed to FATF standards, although the IMF and the World Bank do assess these periodically. Overall, considerable progress has been made in the fight against money laundering since the inception of the FATF in 1989, but much remains to be done.

The FATF actively assesses how well its members adhere to sound AML and ATF standards. I strongly support peer assessment reviews for financial regulators. In addition, the FATF regional bodies play a similar role with non-FATF members. This year the FATF has started its third round of evaluating where its members stand on the FATF Recommendations, including the enhancements to the Recommendations made in 2003.

Internationally agreed Core Principles of Supervision for banks and insurers have this to say about the responsibility of supervisors:

For banks, the BIS core principles state:

“Banking supervisors must determine that banks have adequate policies, practices and procedures in place, including strict "know-your-customer" rules, that promote high ethical and professional standards in the financial sector and prevent the bank being used, intentionally or unintentionally, by criminal elements.”

For insurers, the IAIS core principles read:

“The supervisory authority requires insurers and intermediaries, at a minimum those insurers and intermediaries offering life insurance products or other investment related insurance, to take effective measures to deter, detect and report money laundering and the financing of terrorism consistent with the Recommendations of the Financial Action Task Force on Money Laundering (FATF).”

In 2007 Canada's AML/ATF regime will be evaluated by the FATF. The FATF is placing emphasis on effectiveness. It's not enough to have just a legal framework or

policies and procedures in place, though that is a key pre-requisite. It's how they are working in practice that matters too. Moves to good, risk based supervision relying on financial institution's control and guidance systems is one of the keys to knowing if your system is effective. To date completed FATF evaluations show that insufficient attention is being paid in some countries to AML/ATF supervision. In some cases the challenge relates, not to availability of resources, instead it relates to the way in which prudential supervisors and financial intelligence units work together. I believe that the OSFI/FINTRAC model is an example of how this can be done right, while minimizing overlap and duplication.

Where does Canada stand?

International standards are rising and Canadian standards are being reviewed and reassessed as a result. We've seen the FATF 40+9 Recommendations revised in 2003 and this June, the Department of Finance released a discussion paper on changes needed in our legislation and regulations to meet these standards. In the Preface to this document the Government said: *"These proposals reflect the Government's goal of being at the forefront in the global fight against these crimes, thereby contributing to public safety in Canada and worldwide."* The paper identified these goals:

- Strengthening "know your client" standards;
- Closing gaps in Canada's AML/ATF regime;
- Increasing compliance, monitoring and enforcement;
- Strengthening FINTRAC's intelligence function; and
- Coordinating and assessing overall AML/ATF efforts.

The discussion paper outlines specific areas where it is proposed to raise Canadian statutory requirements in accordance with the FATF Recommendations: new standards for the identification of politically exposed persons, tighter rules relating to correspondent banking, clarification of the requirements in non face-to-face situations, and the use of introducers. All of you will have to deal with these changes so it's important that we work together now to get it right. We know for various reasons that not all of the FATF 49 recommendations can be upheld here, in part because of the Charter, but we aim to be substantially compliant. So there is a need to remain vigilant and to stay on top of the issues as we move forward.

FINTRAC has engaged OSFI, as well as other regulators; to ensure that reporting entities are regularly supervised. FINTRAC has thousands of entities across Canada that are required to report to it, but at the same time FINTRAC has limited resources and is a relatively new organization. On the other hand, OSFI has about 350 financial institutions that are covered under the Proceeds of Crime Act. OSFI has an in-depth knowledge of financial institutions and experience managing information flow both to and from those institutions. We also have experience in assessing the quality of an institutions control, governance and compliance systems. We have also adapted our safety and soundness approach to AML / ATF. So with a large portion of this supervisory infrastructure

already in place, a modest investment in resources has enabled us to lever these abilities into an effective program to assist FINTRAC in assessing compliance with proceeds of crime legislation. At OSFI small deficiencies will not have severe supervisory consequences because we know how hard it is to do AML/ATF well in far-flung, complex operations. But we will come down hard on entities with material problems that should have been identified by them and rectified well before we brought them to light.

OSFI's Compliance Division meets regularly with FINTRAC officials to discuss the progress that individual financial institutions are making in implementing compliance procedures. We also discuss with FINTRAC the positions we take on risk mitigation procedures. We are briefed by FINTRAC on financial institution filings, share our AML/ATF assessment plans with them, and invite FINTRAC to identify any issues with our financial institutions. While we share information with FINTRAC, it is up to them to determine the legal consequences, if any, for internal deficiencies in AML / ATF compliance.

Another bottom line is that OSFI and financial institutions are putting more resources in place, and all this has to result in effective enforcement or willingness of the institutions to do more will wane.

Most of the financial institutions we have assessed so far have assigned a very high level of importance to getting AML/ATF implementation right. A few, mostly smaller, financial institutions have needed more specific guidance. We have also observed a variety of "best practices". Note that "best" doesn't mean "ideal" or "perfect". "Best" means that there are some financial institutions that have good risk management processes in place.

Some financial institutions have taken a historically narrow approach to the implementation of AML/ATF compliance procedures. OSFI's position on the extent to which this legislation should be applied is that any product, be it a deposit product or a loan product such as a mortgage, that can be used to launder dirty money should be subject to strong AML procedures.

What do the institutions need to do?

We believe there are three key areas that each of your organizations can continue to work on in implementing sound AML/ATF policies and procedures to deter and detect money laundering within your institution and generally within the Canadian financial system.

First: Tone from the Top. Executive management and the Board should set the tone for the institution on an enterprise-wide basis, making it clear that loss of reputation due to the financial institutions products and services being used for money laundering or terrorist financing activities will not be tolerated.

A good example of what I'm talking about is the comment we got from the Canadian operations of an international financial institution earlier this year. "Our chairman has made it quite clear that we must know who we are doing business with – it's our reputation that's on the line".

The Chair of another institution said: "We take AML very seriously – it's not only the reputational risk to our institution, but our personal reputations that are at stake here."

Unfortunately in a very few cases with smaller financial institutions we've found boards of directors who were not at all aware of their legal responsibilities. In these cases we act to ensure that they understand the significance of the AML/ATF legislation and to remind them that, as with other risk management controls, it is their job to oversee management in implementing sound compliance and risk management procedures to deal with the risk of money laundering and terrorist financing.

Second: Develop a sound AML/ATF Compliance framework that supports additional risk management controls. Senior management should ensure that programs and resources are in place to comply with domestic and foreign AML/ATF legislation and, where necessary, be prepared to implement additional risk management controls. There needs to be a strong AML/ATF compliance risk management culture which can only be developed with senior management's commitment and support.

Just doing what the law says, sometimes is not enough. As a prudential regulator we expect our institutions to assess the risks and act accordingly. We are pleased when we hear institutions say, we do this because it makes good business sense and helps us to better understand our customers' needs.

Risk management also includes assessing the financial impact of being restricted or not being able to do business in a particular jurisdiction because of inadequate AML/ATF procedures and controls.

Third: Enterprise Wide Ongoing Training and Support: There needs to be an ongoing awareness and training at all levels, from the board of directors to front line staff of how the institution can be used for money laundering and terrorist financing. Staff should feel that they have the support and commitment of senior management and that can be intimidated by the availability of training programs across the organization.

As you will hear from FINTRAC later, they are available to make presentations at all levels from the Board to the teller or mortgage officer.

Conclusion

I hope you find today's session informative. Your support is imperative if we are to have an effective regulatory AML/ATF regime in place. Thank you for your time today.