



Guideline

Subject: Deterring and Detecting Money Laundering and Terrorist Financing

Category: Sound Business and Financial Practices

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Money laundering and terrorist financing activities (MLTFA) continue to be a serious international problem that is receiving increasing attention as nations attempt to deal with issues such as organized crime and terrorism. Financial institutions, in particular, are at risk of being used by criminal organisations to launder money and by terrorist groups to facilitate the financing of their activities.

When necessary, this Guideline references the work of the Financial Action Task Force on Money Laundering (FATF), the international body, of which Canada is a member, that develops and monitors international anti-money laundering and terrorist financing standards.

This guideline is intended to identify some of the steps that federally regulated financial institutions (FRFIs) should take to assist their compliance with the various legal requirements related to deterring and detecting money laundering and terrorist financing and, more generally, to minimize the possibility that they could become a party to MLTFA. Effective policies and procedures are essential to reducing the risk that facilitating MLTFA poses to FRFIs' reputations and operations. Both management and the boards of directors of FRFIs are responsible for the development of specific policies and procedures for deterring and detecting MLTFA as well as for ensuring that FRFIs adhere to those policies and procedures. OSFI also expects that institutions will be able to demonstrate, on request, that they have developed and implemented policies and procedures consistent with this guideline, and that staff are applying them as intended.

OSFI works closely with the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) concerning the policies and procedures that FRFIs have in place for complying with Part I of the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act (PCMLTFA)*. On June 14, 2004 OSFI and FINTRAC signed a Memorandum of Understanding for exchanging information relating to compliance with Part I of the PCMLTFA, pursuant to the *Public Safety Act, 2002*.

Certain provisions of the PCMLTFA and the *Criminal Code* give both FINTRAC and OSFI responsibility for dealing with issues related to the financing of terrorist activities. FINTRAC's objectives now include the detection, prevention and deterrence of the financing of terrorist activities, while OSFI has assumed the role of a central reporting point for the aggregate reporting requirements outlined in subsection 83.11(2) of the *Criminal Code*.

With respect to FRFIs' reporting requirements to OSFI related to terrorist assets, OSFI posts on its Web site (www.osfi-bsif.gc.ca) lists of terrorist individuals and organizations, and will continue to receive reports from FRFIs as required by the *United Nations Suppression of Terrorism Regulations* or by subsection 83.11(1) of the *Criminal Code* in respect of entities listed in the *Regulations Establishing a List of Entities* made under subsection 83.05(1) of the *Criminal Code*. In addition, FINTRAC and a number of international organisations have published information related to terrorist financing activities. FINTRAC has also issued a guideline on Submitting Terrorist Property Reports. FRFIs should keep in mind that the financing of terrorist activities is sometimes linked to money laundering. In addition, actual or suspected FRFI involvement in facilitating the financing of terrorist activities may expose FRFIs to risks similar to those related to the facilitation of money laundering.

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I. Introduction and Background

This guideline applies to banks, authorized foreign banks in respect of their business in Canada (foreign bank branches or FBBs), companies to which the *Trust and Loan Companies Act* applies, cooperative credit associations subject to the *Cooperative Credit Associations Act*, and life insurance companies or foreign life insurance company branches to which the *Insurance Companies Act* applies. For the purposes of this guideline, they will be referred to as federally regulated financial institutions (FRFIs). FRFIs should ensure that subsidiaries having potential exposure to money laundering or terrorist financing activities follow the guideline.

This guideline reflects actions taken both nationally and internationally to deal with money laundering and terrorist financing. Key among the actions taken in Canada has been the enactment of the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (PCMLTFA), the creation of the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) and the development of the current transaction reporting regime. FRFIs should be aware of the specific requirements related to customer identification set out in the PCMLTFA and the Regulations¹. Both the PCMLTFA and the Regulations are available from the Department of Justice Web site (<http://www.canada.justice.gc.ca>) and from the FINTRAC Web site (<http://www.fintrac.gc.ca>).

FINTRAC, an agency of the federal government, is Canada's financial intelligence unit and has a mandate to collect, analyze and assess information related to money laundering and terrorist financing activities, and to disclose certain information to law enforcement and intelligence authorities to assist in the detection, prevention and deterrence of these criminal activities. FINTRAC is also responsible for ensuring that FRFIs comply with the record keeping, reporting, and customer identification requirements set out in Part 1 of the PCMLTFA and the accompanying Regulations. More information on FINTRAC is available on its Web site, noted above.

Specific requirements related to the reporting of various transactions are outlined in the Regulations and in FINTRAC guidelines. The Regulations set out reporting and record keeping requirements for suspicious transactions (including terrorist property reporting), large cash transactions and international electronic funds transfers. Among other things, the Regulations outline requirements for client identification, retention of records, and the implementation of a compliance regime, including staff training. Please refer to the FINTRAC Web site for copies of the PCMLTFA, Regulations, and FINTRAC guidelines, as well as for general information related to money laundering and terrorist financing.

¹ *Proceeds of Crime (Money Laundering) and Terrorist Financing Regulations and Proceeds of Crime (Money Laundering) and Terrorist Financing Suspicious Transactions Regulations.*

II. Programs to Combat MLTFA

(a) MLTFA Risks

Financial regulators and international organizations recognize that MLTFA is a serious problem that can pose a number of risks to financial institutions. The failure of a financial institution to implement adequate anti- MLTFA policies and procedures can have a negative impact on its reputation and, consequently, on its ability to carry on business.

FRFIs that fail to implement adequate measures in relation to the prevention of money laundering and the reporting of terrorist financing activities are exposed to potentially serious regulatory intervention initiatives, both domestically and internationally.

Consistent with the duty of care imposed by FRFI legislation on boards of directors and on officers of FRFIs, standards of sound business and financial practices, and OSFI's Supervisory Framework, which focuses on identifying and mitigating risks, FRFIs should have anti- MLTFA policies and procedures in place that are adapted to their individual situations. Where appropriate, these policies and procedures should articulate a group- or enterprise-wide standard, applicable to the FRFI itself, all domestic or foreign subsidiaries and all foreign branches. In October 2004, the Basel Committee on Banking Supervision (Basel Committee) published a paper entitled [*Consolidated KYC Risk Management*](#) that emphasises the importance of banks managing risks on a global consolidated basis. This paper addresses explicitly the need for financial institutions to be able to share information with their head offices and urges jurisdictions in which legal impediments remain to remove them. The Basel Committee intends this paper to be read in conjunction with its paper [*Customer Due Diligence for Banks*](#).

FRFIs should design these policies and procedures to ensure compliance with legal requirements related to deterring and detecting MLTFA. As appropriate, such policies and procedures should be broad enough to not only include specific legal requirements but also take into account the business environment and activities specific to the institution. Policies and procedures should be formally documented. Not only will this assist OSFI and FINTRAC, it will also enhance a FRFI's internal compliance function and the overall effectiveness of its policies and procedures.

The policies and procedures should include measures to permit the FRFI to identify and report Large Cash Transactions as required by the PCMLTFA and the Regulations. The policies and procedures should also include measures to monitor transactions. These measures will help FRFIs to identify potentially suspicious transactions by using criteria that will enable them to detect unusual or abnormal activity. Where appropriate (for example, where the volume of transactions is high), FRFIs should consider whether monitoring activity could be strengthened by information technology solutions.

To identify their level of exposure to potential MLTFA and the associated risks, FRFIs must understand the nature of the risks associated with the different parts of their operations:

Products and Services

Although MLTFA are frequently associated with deposit accounts, other financial products, such as loans, mortgages and other credit products, may also be used to hide the proceeds of crime or terrorist funds. For life insurers, attention should be paid to products and services that permit a customer to make substantial funds withdrawals and/or large single-premium payments.

Customers

Both the FATF and the Basel Committee believe that it is vital that financial institutions adequately identify those who beneficially own corporate customers who do business with them. This goes further than merely ascertaining that an entity exists. The FATF recommends that financial institutions “understand the ownership and control structure” of their customers. OSFI suggests that this principle is particularly important when dealing with privately owned companies, trusts and customers that may have more complex legal structures. In addition, certain customers may merit additional due diligence. Examples could include businesses that handle large amounts of cash, or that deal in luxury or high-end consumer goods. Finally, customers that hold important public positions (often referred to as “politically exposed persons”) may require special attention.

Reliance on Others

FRFIs that outsource record keeping or other functions that form part of their PCMLTFA compliance regime, or that utilize introducers to gather new business (such as deposit brokers, mortgage brokers, correspondents, law firms, accounting firms, etc., including those outside Canada) are reminded that they retain full accountability for having customer identification and verification processes, and for obtaining customer records with respect to accounts opened through such sources.

With respect to introduced business, FRFIs must obtain the necessary customer information for their records prior to, at, or at a reasonable time after, the time that the business is accepted. OSFI recommends that relationships with introducers be subject to written agreements to ensure that the responsibility for collecting and verifying customer identification information is clearly understood. FRFIs should consider terminating relationships with introducers that cannot, or fail to, provide the FRFI with the requisite customer identification and verification data that the FRFI is required to obtain under the PCMLTFA and the Regulations.

Geography

FRFIs with operations that conduct business in offshore jurisdictions, or that have customers that operate in those jurisdictions, need to be especially vigilant. The FATF and the IMF/World Bank have highlighted the risks of doing business internationally, and issue reports identifying jurisdictions that have deficiencies in their anti-money laundering regimes, or that are Non-Cooperating Countries and Territories (NCCTs).² Enhanced due diligence may be required for certain electronic funds transfers (particularly those from outside Canada, non-customers or non-correspondent banks), or pass-through accounts at FRFIs that are opened by foreign institutions to allow their customers to conduct business in Canada. Higher levels of due diligence are necessary when processing transactions connected to NCCTs, and may also be necessary when processing transactions connected to countries that are not considered to have adequate anti-MLTFA requirements. FRFIs are encouraged to adopt country risk policies that address these and related issues.

We draw the attention of FRFIs to the risks involved in dealing with “shell” banks (banks that do not have a physical presence in any country), and in light of applicable international standards, OSFI encourages all FRFIs to adopt measures which will ensure that they do not enter into correspondent banking relationships with shell banks.

FRFIs should note that the Regulations do not permit the same degree of reliance on the acceptance of cheques drawn on banks outside Canada as they do for cheques drawn on Canadian institutions. Therefore, it is suggested that FRFIs ensure that if they accept foreign cheques, they are satisfied with the reputation and standing of the foreign institution upon which such cheques are drawn. The degree of potential exposure to MLTFA should be understood, and the implementation of measures to deter and detect these activities should be flexible in order to reflect the features of different products and service locations, as well as changes in legal requirements.

(b) Board and Management Oversight

Given their ultimate responsibility for the effectiveness of the FRFI’s anti- MLTFA program, the board of directors and senior management must be strongly committed to ensuring that measures designed to address risks associated with these activities are implemented. It is essential that both the board of directors and senior management support these programs through all stages - design, approval, implementation, and review. The board and senior management should be

² The FATF provides updates on the progress being made by jurisdictions named in its report and conducts reviews of additional countries and jurisdictions. Jurisdictions making sufficient progress in strengthening their anti-money laundering regimes are de-listed, while others may face various countermeasures if progress is insufficient. To obtain additional information on this report or on other FATF activities, FRFIs should refer to the FATF Web site located at <http://www.oecd.org/fatf>.

directly involved in the approval and review stages, principally throughout the receipt and review of the FRFI's self-assessment discussed under (c)(v) below.

(c) Policies and Procedures

Senior management is responsible for the development of risk management programs and for keeping the board of directors adequately informed about these programs and their effectiveness. Policies and procedures to combat MLTFA should form an integral part of a FRFI's overall compliance function. The following steps would form a sound basis for a comprehensive set of policies and procedures to deter and detect these activities.

- i) Ensure that the FRFI has sufficient qualified resources to comply with all legal requirements.
- ii) Name a "designated officer" to be responsible for corporate-wide measures to combat MLTFA and who will report directly to senior management and the board of directors. The designated officer should ensure that each operating division of the FRFI having potential exposure to MLTFA appoints an officer to ensure that these divisions carry out policies and procedures as required. These officers should report regularly on compliance issues and the need for any revisions to policies and procedures. FRFIs should designate employees (who need not be full time compliance officers) to be accountable for ensuring that anti- MLTFA policies and procedures intended for these branches or units are applied.
- iii) Ensure that managers are aware of their overall compliance responsibilities, and, in particular, those linked to areas such as MLTFA where non-compliance has the potential to cause damage to the FRFI's reputation.
- iv) Establish internal compliance reporting processes³ capable of demonstrating, at a minimum, conformity with all anti- MLTFA legal requirements. Further, the internal compliance reporting system should provide for regular reviews of compliance issues, for the documentation of such reviews, and for a process to address instances of non-compliance or any general areas of weakness identified. Where a FRFI believes the review has identified significant issues, it should review such issues with OSFI. Policies and procedures should be adequately documented to permit independent testing (referred to below) and OSFI to understand the processes described.
- v) Establish an annual self-assessment program designed to 1) evaluate, on a group-wide basis, the effectiveness of the FRFI's anti- MLTFA procedures for identifying areas and types of risk, and 2) suggest corrective measures to address any weaknesses or gaps identified in the risk management systems. The annual self-assessment should include a

³ It should be noted that OSFI has issued guidance on legislative compliance management and that it refers to compliance requirements in both FRFI governing statutes (e.g., *Bank Act*) and in other legislation that affects FRFIs, such as the PCMLTFA.

report for senior management and the board of directors that summarizes the assessment's findings, including the scope of the review, the main elements of anti-MLTFA policies and procedures, the level of adherence to them, and evidence that the policies and procedures comply with the PCMLTFA and the Regulations, and with applicable FINTRAC and OSFI guidelines.

- vi) Establish a system of independent procedures testing to be conducted by the internal audit department, compliance department, or by an outside party such as the FRFI's external auditor. Where anti-MLTFA testing is incorporated into all regular or cyclic testing of other internal controls, procedures testing should cover the entire operation of the FRFI no less frequently than the testing of such other internal controls. Otherwise, the procedures testing should be conducted annually.

The scope of the testing and results should be documented, with deficiencies in anti-MLTFA systems being reported to senior management and to the board of directors, and with a summary of steps taken (or to be taken) to address any deficiencies. The report should address areas such as: employee knowledge of legal requirements and the FRFI's policies and procedures; the FRFI's systems for client identification and for suspicious and large cash transaction identification and reporting; and the associated record-keeping system.

- vii) Ensure that appropriate employees are given sufficient training. This should include knowledge of the FRFI's anti-MLTFA policies and procedures, the techniques⁴ used by criminals to launder funds through financial institutions, and the current anti-MLTFA legislation and regulations. Front-line staff plays an essential role in implementing anti-MLTFA measures and, therefore, must receive appropriate training to understand problems associated with MLTFA, the financial institution's anti-MLTFA policies, and the proper application of procedures.

(d) Customer Identification

Comprehensive customer identification policies and procedures can greatly reduce the risk of exposure to money laundering and terrorist financing activities, and should form a key part of an anti-MLTFA program. International bodies such as the FATF and the Basel Committee recognize the importance of customer identification on Banking Supervision (Basel Committee). The International Association of Insurance Supervisors (IAIS) has also issued anti-money laundering guidance that highlights the importance of customer identification issues.

In October 2001, the Basel Committee released a final version of its paper entitled *Customer Due Diligence for Banks*. The paper sets out minimum standards for the development of

⁴ The three stages of money laundering (placement, layering and integration) should be covered by appropriate training material, ideally geared to the FRFI's own products and services.

appropriate practices in this area. OSFI believes that the customer due diligence standards identified in this paper represent a sound basis for ensuring that FRFIs have adequate “know your customer” controls and procedures in place. OSFI encourages FRFIs to familiarize themselves with the standards outlined in the paper and to implement these standards in a manner appropriate to the size, complexity, and nature of the institution’s business activities. The paper is available on the BIS Web site (<http://www.bis.org/publ/bcbs85.pdf>).

More recently, the FATF has made substantial revisions to its Forty Recommendations, which can be referenced at the FATF Web site (http://www.fatf-gafi.org/40Recs_en.htm). The FATF has also released a number of Special Recommendations on Terrorist Financing, some dealing more specifically with roles and responsibilities of financial institutions for combating terrorist financing activities (http://www.fatf-gafi.org/TerFinance_en.htm).

The IAIS approved the final draft of its *[Guidance Paper on Anti-Money Laundering and Combating the Financing of Terrorism](#)* in October 2004. The Guidance Paper, which replaces anti-money guidance notes issued in January 2002, now addresses issues related to the combating of terrorist financing. The Paper is also more consistent with the FATF’s Forty Recommendations and includes enhanced guidance with respect to customer due diligence. When developing or modifying their anti- MLTFA programs, life insurance entities should familiarize themselves with this document, as it provides a strong summary of key elements of an anti- MLTFA program from an insurance entity perspective.

III. Review by the Office of the Superintendent of Financial Institutions

As part of its risk-based supervisory framework, OSFI reviews the adequacy of FRFIs' enterprise-wide anti- MLTFA policies and procedures, and their implementation, to determine whether FRFIs are taking appropriate steps to address MLTFA and associated risks. OSFI may share results of these reviews with FINTRAC⁵, as they relate to compliance with Part 1 of the PCMLTFA. FRFIs should be prepared to provide information or material on MLTFA deterrence and detection procedures to OSFI personnel when they are conducting an on-site review and, upon request, at any other time. (Note: additional information related to the items below can be found in Section II(c).) Material that may be examined would include, but would not necessarily be limited to:

- i) Board-approved policies on anti- MLTFA and related procedures;
- ii) The self-assessment referred to in (c) (v) above;
- iii) Documented evidence of tests undertaken to confirm the appropriate functioning of the entity’s anti- MLTFA policies and procedures;

⁵ In accordance with section 97 of Bill C-7 (the *Public Safety Act*, 2002).

- iv) The name of the officer designated as responsible for the institution's overall MLTFA deterrence and detection procedures, usually referred to by OSFI as the Chief Anti-Money Laundering Officer (CAMLO);
- v) A description of the frequency and type of reporting to the CAMLO and by the CAMLO to senior management and the board;
- vi) Electronic or paper evidence (could include FINTRAC confirmation of report filings) of all suspicious transaction, large cash transaction, electronic funds transfer, and other reports made by the FRFI pursuant to its reporting obligations; and
- vii) Evidence of a summary report to senior management in respect of suspicious transactions reports and large cash transaction reports that were made to FINTRAC.

- END -

Reference Web Sites

The following is a list of organisations and their Web sites where additional information may be obtained regarding the prevention of MLTFA. Many of the sites provide search engines that can be of assistance in obtaining helpful documentation.

Domestic Organisations

Office of the Superintendent of Financial Institutions (OSFI)

<http://www.osfi-bsif.gc.ca/>

Financial Transactions and Reports Analysis Centre of Canada (FINTRAC)

<http://www.fintrac.gc.ca/>

Foreign Regulators and International Organisations

Bank for International Settlements (BIS)

<http://www.bis.org/>

Financial Action Task Force on Money Laundering (FATF)

<http://www1.oecd.org/fatf/>

International Association of Insurance Supervisors (IAIS)

<http://www.iaisweb.org/>

Board of Governors of the Federal Reserve System (Federal Reserve)

<http://www.federalreserve.gov/>

Office of the Comptroller of the Currency (OCC)

<http://www.occ.treas.gov/>

Financial Crimes Enforcement Network (FinCEN)

<http://www.treas.gov/fincen/>

U.K. Financial Services Authority (FSA)

<http://www.fsa.gov.uk/>

Australian Transaction and Reports Analysis Centre (AUSTRAC)

<http://www.austrac.gov.au/>