Financial Transactions and Reports Analysis Centre of Canada

Centre d'analyse des opérations et déclarations financières du Canada

**PROTECTED B**

**Advice to Minister**

# FINTRAC Report to the Minister of Finance on Compliance and Related Activities

September 30, 2017

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# I. INTRODUCTION

This report presents the Financial Transactions and Reports Analysis Centre's (FINTRAC, or the Centre) compliance activities conducted in 2016-17 and highlights trends, challenges, and upcoming priorities. In the last fiscal year, FINTRAC conducted extensive engagement activities with reporting entities and their associations through training, outreach, and development of guidance and policy interpretations. These activities aimed to assist reporting entities meet new obligations and strengthen compliance of existing ones. The report also highlights findings for examinations conducted in the banking, real estate, casino and money services business (MSB) sectors, as well any follow-up action taken to respond to non-compliance.

The last section of the report provides an overview of changes to FINTRAC's approach to compliance, including changes to the administrative monetary penalties program, issues concerning its public naming authority, and changes to the examination methodology.

# II. OVERVIEW

As Canada's financial intelligence unit, FINTRAC is responsible for the detection, prevention and deterrence of money laundering and terrorist financing (ML/TF). It achieves this through its compliance and intelligence functions. As a regulator, FINTRAC ensures that reporting entities comply with obligations under the PCMLTFA and associated Regulations through engagement and enforcement activities. Compliance activities also serve to deter the criminal use of Canada's financial system.

FINTRAC's other function is to deliver high-quality, relevant and timely financial intelligence to appropriate domestic law enforcement and intelligence agencies as well as to its foreign counterparts. FINTRAC discloses this intelligence once it has reached reasonable grounds to suspect that designated information would be relevant to an investigation or the prosecution of an ML/TF offence. In all its activities, FINTRAC ensures that both functions remain clearly separated to protect the personal information that it receives.

Over the last few years, FINTRAC has adopted a mantra of compliance for intelligence, which aims to maximize the intelligence value of information that it receives and to address potential compliance vulnerabilities proactively. Thus, FINTRAC established a dedicated team to work with its major reporters and targeted outreach efforts to all reporting entities on suspicious transactions. Through this work, FINTRAC has helped reporting entities increase this type of reporting by 63% over the past five years. By

keeping abreast of law enforcement and national security partner priorities, FINTRAC has also significantly enhanced the value of the financial intelligence it provides.

FINTRAC's compliance program has matured over the years, as seen in its recent shift away from a traditionally "audit" approach to compliance. Over the last two fiscal years, FINTRAC solidified a renewed "assessment" approach that places emphasis on the effectiveness of reporting entities in meeting obligations under the PCMLTFA, as well as the impact of non-compliance on the objectives of the PCMLTFA and on FINTRAC's mandate. FINTRAC began to apply the assessment approach in some of the examinations conducted in 2016-17.

## III. COMPLIANCE ACTIVITY HIGHLIGHTS FOR 2016-17

### A) Engagement Activities

In 2016-17, FINTRAC delivered presentations and engagement sessions across all reporting entity sectors. As well, it engaged its regulatory agency counterparts and international partners to promote collaboration and educate partners on the important role they play in the AML/ATF regime. In addition, FINTRAC worked towards implementing new and upcoming legislative and regulatory changes. This included efforts to review and modernize FINTRAC's guidance, as well as extensive outreach with reporting entities to assist them in meeting new obligations.

#### 1. FINTRAC Engages with Major Reporters

Over the course of the year, FINTRAC engaged with major reporters, which include Canada's seven largest banks and the Fédération Desjardins. Collectively, these reporting entities submit almost 90% of all reports to FINTRAC. The Centre hosted the third annual Major Reporters Forum in Toronto in September 2016. The Forum enables stakeholders to discuss important subjects of mutual interest. FINTRAC shared current priorities regarding terrorist financing, as well as information on money laundering threats from the Hells Angels Motorcycle Club.

FINTRAC also leveraged the forum to obtain information to respond to the Group of Seven (G7) Action Plan on Combatting the Financing of Terrorism. One of the actions described in the Plan is to enhance cooperation with relevant private sector entities to better detect terrorist financing. During the forum, attendees discussed current best practices and brainstormed potential new and innovative ways to enhance cooperation. The participants provided valuable information to FINTRAC, which was reflected in the Centre's response to the G7.

FINTRAC recognizes that there remains a need for greater collaboration between AML/ATF regime partners and private sector entities, as highlighted in the G7 Action

Plan. Other international organizations, such as the Financial Action Task Force (FATF), the Egmont Group and the Five Eyes continue to raise the importance of information sharing between public and private AML/ATF regime actors. FINTRAC supports proposals submitted for the upcoming Parliamentary Review of the PCMLTFA that examine opportunities to strengthen information sharing across the AML/ATF regime, including between private sector entities. FINTRAC will continue to work with the Department of Finance toward any such endeavour, recognizing both the value of information sharing, as well as privacy rights of Canadians.

**2. FINTRAC is Modernizing its Guidance and Consulting Entities on Upcoming Products**

FINTRAC is modernizing its guidance products for all reporting sectors, aiming to present information that is easy to navigate, clear and concise. The project also aims to clarify how FINTRAC assesses reporting entity obligations during examinations. In addition, guidance updates were required in support of regulatory changes. To this end, FINTRAC held 25 consultation sessions with reporting entity sector representatives and industry associations to enhance their understanding of the new obligations and to provide an overview of the new guidance that it will publish in the next fiscal year. The Centre developed clear guidance with the input from these consultations, as well as from feedback received from the Office of the Superintendent of Financial Institutions (OSFI).

**3. FINTRAC Conducts Outreach Activities to Help Reporting Entities Meet Obligations**

In addition to these consultation sessions, FINTRAC undertook more than 30 outreach activities across the country. For example, FINTRAC met with the Jewellers Vigilance Canada and the Canadian Jewellers Associations in the dealers in precious metals and stones (DPMS) sector. FINTRAC presented on the sector's strengths and weaknesses in meeting compliance obligations to enable these associations to better assist their members. On occasion, it provided training to reporting entities on matters such as the reporting of suspicious transactions.

FINTRAC also used these outreach opportunities to discuss the coming into force of new regulatory amendments. For example, FINTRAC participated in a panel with other provincial gaming regulators at the Canadian Gaming Summit in Ottawa in June 2016. FINTRAC engaged in discussions on the legislative changes to the definition of the term "casino" and its impact on the gaming sector.

**4. FINTRAC Engages with the Private Sector on FinTech**

FINTRAC began working with private sector stakeholders in 2016-17 to develop and share expertise on new financial technologies and their potential impact on the AML/ATF regime. It engaged with reporting entities and private sector FinTech

businesses to support ongoing efforts to identify ML/TF risks. Through this work, FINTRAC kept abreast of trends in emerging financial technologies. FINTRAC has also actively contributed its expertise to interdepartmental initiatives on new financial technologies and their impact on the AML/ATF regime. For example, FINTRAC is a member of the Innovation, Science and Economic Development Canada (ISED)-led Interdepartmental FinTech Working Group.

The Centre developed a suite of products to raise awareness and explain the potential impacts of new financial technologies on the AML/ATF regime, and on the detection and deterrence of ML/TF. This includes the FinTech Watch, a monthly newsletter on FinTech, and research reports that are shared with regime partners, domestic and international allies as well as private sector stakeholders.

## 5. FINTRAC Modifies and Strengthens its Policy Interpretation Process

*New Standards Are Required to Respond to Increasingly Complex Policy Interpretation Requests*

In fiscal year 2016-17, FINTRAC issued 278 policy interpretations in response to increasingly complex questions received from reporting entities, industry associations, regulators and the public. FINTRAC has observed that reporting entities have become more familiar with the regime and legislative requirements; therefore, the policy interpretation requests have become more complex.

Certain policy interpretations on issues such as client identification methods and beneficial ownership information related in part to the operations of other government agencies and to interdepartmental policy development. Therefore, they necessitated external consultations with key stakeholders such as OSFI, the Department of Finance, major reporters and industry associations. Consequently, FINTRAC's standard which is to provide a response within 30-days is no longer adequate for complex cases. FINTRAC is reviewing its operating procedures to introduce a new set of service standards that takes the level of complexity, priority and impact of the request into account.

*FINTRAC Responds to Government of Canada Priorities on Beneficial Ownership*

FINTRAC recognizes that the issue of beneficial ownership is a global preoccupation. In Canada, beneficial owners are the actual persons who directly or indirectly own or control 25% or more of a legal entity, which includes corporations. Lack of transparency on beneficial ownership information is an ML/TF concern as it masks the true identity of individuals benefiting from or involved in ML/TF schemes and thus impedes law enforcement investigations.

Under the PCMLTFA, several reporting entity sectors are required to verify and keep a record of beneficial ownership information when confirming the existence of a legal

entity and to take reasonable measures to verify that the information is accurate. However, reporting entities have expressed concerns related to the availability and accuracy of this information and the resulting challenges in their ability to comply with these obligations.

In the last fiscal year, FINTRAC conducted research in support of efforts to improve the AML/ATF regime with respect to the transparency of legal entities. One outcome of the project was the production of a report that examined the money laundering risks associated with the lack of adequate, accurate and timely beneficial ownership information. FINTRAC will continue to work with the Department of Finance in support of initiatives to address beneficial ownership issues in Canada in order to strengthen the AML/ATF regime and to address gaps identified by the FATF.

*FINTRAC Responds to Policy Interpretation Requests Regarding Changes to the Definition of Money Services Business in the PCMLTFA.*

FINTRAC responded to a number of policy interpretation requests stemming from legislative amendments that expanded the definition of "Money Services Business" (MSBs) to include businesses "dealing in virtual currencies." These amendments aimed to mitigate risks and vulnerabilities associated with emerging technologies, while not hindering innovation.

Enquiries received in the last fiscal year indicate that, in certain cases, FinTech businesses subject to the PCMLTFA and its associated Regulations were not aware of their obligations. Although the new definition of MSBs under the PCMLTFA is not yet in force, it is important for businesses to understand that they may currently meet the criteria to be considered a reporting entity through the services they offer and are required to register with FINTRAC as an MSB. As the Department of Finance works on regulations to specify which virtual currency activities will be covered, FINTRAC expects to receive an increasing number of these enquiries.

## 6. Operational Alerts and Briefs Inform Reporting Entities of Key ML/TF Indicators

In 2016-17, FINTRAC continued to work with reporting entities to define indicators, risk factors and vulnerabilities related to ML/TF. These discussions, along with FINTRAC's internal strategic analysis, informed FINTRAC's Operational Alerts and Operational Briefs. FINTRAC developed these products to support reporting entities in meeting their obligations; to help them identify potentially suspicious transactions; and to provide them with tools to address potential vulnerabilities to exploitation for ML/TF purposes. FINTRAC published five of these products, including an Operational Alert on money laundering indicators associated with human trafficking and another on high-risk currency exchange houses in Daesh-accessible territory in Iraq.

### 7. FINTRAC Engages with Foreign Counterparts

In the last fiscal year, FINTRAC attended the International Supervisory Forum (ISF) meeting. The ISF was established in 2013 by AML/ATF regulatory agencies from the Five Eyes countries and provides a venue for sharing information and best practices.

R2 (PII) Ongoing investigations/active intelligence; R3 (PII) Injury to national defence, security or international relations; R6 (PII) The proper administration or enforcement of an Act

As a result of the meeting, ISF members committed to several information sharing initiatives. For instance, the ISF agreed to maximize the exchange of compliance information among members, while respecting the information sharing boundaries of each jurisdiction, and participate in ISF teleconferences every two months. The ISF will also ensure that a member participates in each of the Five Eyes Law Enforcement Proceeds of Crime Working Group meetings. Finally, the ISF agreed to launch a new project on mass marketing fraud in collaboration with MSBs and to discuss producing ML/TF trends and typologies specific to the sector.

## B) Effectiveness of Compliance Activities

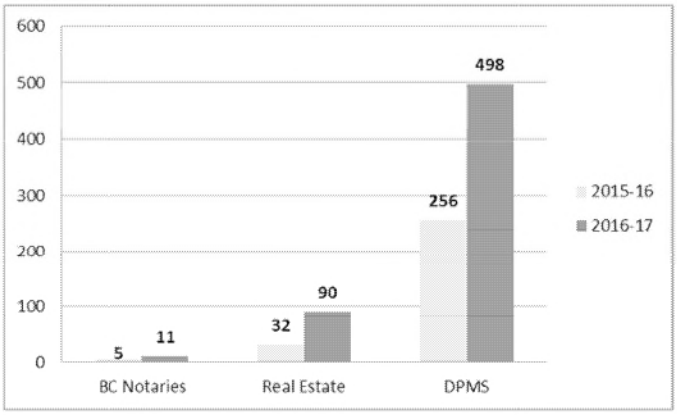
### 1. Suspicious Transaction Reporting

Under the PCMLTFA, reporting entities are required to submit suspicious transaction reports (STRs) to FINTRAC when they have reasonable grounds to suspect that a transaction is related to a money laundering or terrorist financing offence. In 2016-17, FINTRAC saw an increase in the number of STRs reported. It also effectively identified and cited reporting entities that failed to report STRs.

*FINTRAC Received a Greater Number of STRs from Traditionally Low-Reporting Sectors*

The number of STRs submitted by each sector increases each year. Although numbers are small in certain sectors, FINTRAC is encouraged by the increased reporting of the British Colombia (B.C.) notaries, real estate, and DPMS sectors, which are sectors that traditionally submit low volumes of STRs. Figure 1 shows the increase in STR reporting by the three sectors compared to the previous fiscal year.

**Figure 1: Number of STRs submitted by low-reporting sectors over FY 2015-16 and 2016-17**

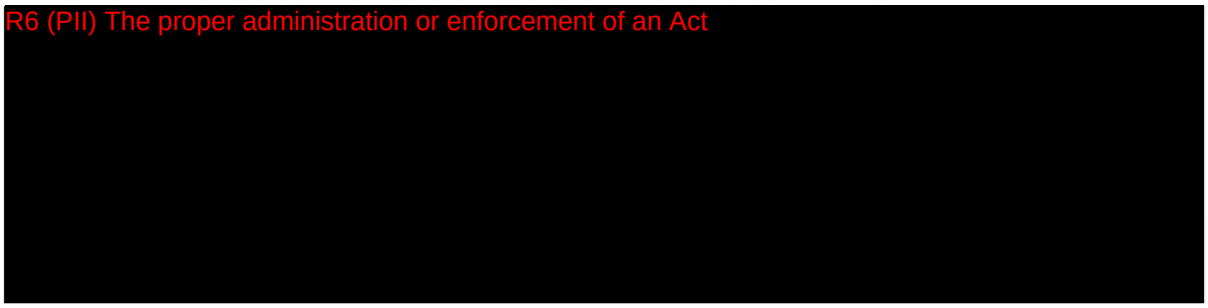


FINTRAC believes that this increase largely results from outreach efforts, including an Operational Alert that FINTRAC issued in November 2016 on indicators of money laundering in financial transactions related to real estate. This alert was disseminated to all reporting entities that deal in selling, buying and developing in real estate. FINTRAC hopes that the number of STRs submitted by these sectors will continue to increase with outreach.

*FINTRAC Effectively Identifies Unreported STRs*

Identifying unreported STRs during examinations is complex as the Centre must assess and analyze all the information surrounding the client and the transaction(s) to determine whether a reporting entity actually had reasonable grounds to suspect a suspicious transaction and should have reported the transaction(s) to FINTRAC.

R6 (PII) The proper administration or enforcement of an Act



The process requires time and the ability to sift through a sizable amount of information. To this end, FINTRAC allocated more time and worked on developing compliance officers' skills to assess this deficiency during examinations. In 2016-17, 15 reporting entities were found to have deficiencies in this area, compared to 10 in the previous fiscal year. These findings point to FINTRAC's increasing effectiveness in its ability to detect this deficiency.

**2. Database Examination Reviews Measure Changes in Reporting Behaviour**

FINTRAC conducts three types of examinations: desk, onsite and database. The desk examination enables FINTRAC to verify information that has been provided by the reporting entity and addresses the presence of regime elements and the quality of records and reports. Onsite examinations are more thorough and enable FINTRAC to determine the presence and effectiveness of regime elements, the quality of records and reports, and the extent of omissions and incomplete information.

In addition, FINTRAC conducts database examination reviews to assess the quality and timing of submitted reports when it observes a high number of quality issues with a specific reporting entity during a previous examination. The outcome of a database examination review determines whether a follow-up is required to address ongoing

reporting deficiencies. These examinations effectively encourage an improvement in the reporting behaviour of reporting entities.

In the last fiscal year, FINTRAC conducted 104 database examination reviews. Of these, only 11 (11%) were recommended for a follow-up examination as a result of continued reporting deficiencies. The most common deficiencies across all sectors and all report types included quality issues with some of the reporting fields (such as the occupation, address, or type of document used to identify the person or entity conducting the transaction). A deficiency specific to large cash transaction reporting obligations was the quality of the reporting field on the type of business of a third party involved in the transaction.

In the remaining 93 (89%) cases, 71 (68%) showed improvement in reporting behaviour in the six months following the examination, and for 22 (21%) of them FINTRAC did not have sufficient data to conduct an assessment at that time. Four of the cases demonstrating improvement qualified for a Letter of Acknowledgement of Improvement. This letter informs entities that FINTRAC deems reporting improvements as satisfactory and no further compliance action is required.

### C) Compliance Examinations by Sector

FINTRAC conducted a total of 661 examinations (262 desk and 399 onsite examinations) across all reporting entity sectors, compared to 739 conducted in the previous fiscal (see Annex A for details on FINTRAC's examination strategy in fiscal year 2016-17). The Centre conducted fewer examinations in this fiscal year due to a number of factors, such as the increased complexity of several examinations focusing on STR reporting obligations and FINTRAC's shift toward a renewed approach to compliance that aims to assess the effectiveness of a reporting entity's compliance program. Section IV of this report provides more details on this approach.

In the last fiscal year, FINTRAC began to conduct some examinations using its assessment approach. Under the old approach, a reporting entity could be found to have very significant levels of non-compliance based on the cumulative score that it received for deficiencies in several minor areas. Now, FINTRAC places greater emphasis on a reporting entity's overall effectiveness in complying with the PCMLTFA.

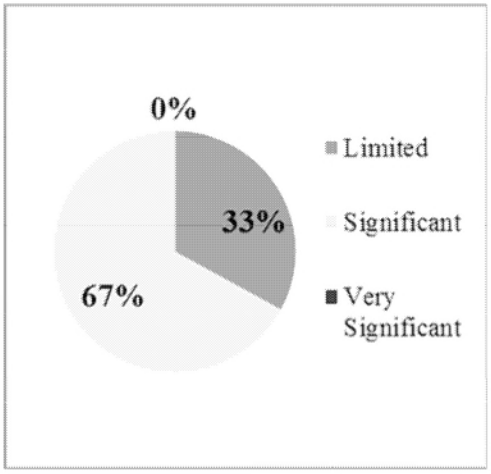
For this reason, year to year comparisons on examination findings may not accurately reflect sector-wide improvements or weaknesses. Therefore, this report attempts to provide general trends identified during FINTRAC examinations in 2016-17.

## 1. Banking Sector

In 2016-17, FINTRAC examined nine banks, including two concurrent examinations with OSFI. Figure 2 presents the overall level of non-compliance found in these examinations.

During an examination, FINTRAC does not assess all compliance obligations of a given reporting entity. FINTRAC's risk-based approach informs which obligations are included and assessed in the scope of each examination. Based on examination findings, FINTRAC calculates the overall level of non-compliance of the reporting entity. In examinations of the banking sector, no banks were found to have very significant levels of non-compliance; however, 67% were found to have significant levels of non-compliance. Deficiencies were identified in obligations related to STR-reporting, risk assessment, and policies and procedures, as explained below.

**Figure 2: Overall Level of Non-Compliance of Banks Examined in 2016-17**




*Examinations in the Banking Sector Reveal Challenges with STR Reporting*

During examinations conducted in 2016-17, banks demonstrated challenges with

R6 (PII) The proper administration or enforcement of an Act

[redacted]

*FINTRAC Assists the Sector to Meet Reporting Obligations*

FINTRAC intends to respond to ongoing challenges related to STR reporting through the modernization of its guidance on suspicious transaction reporting to better explain its expectations. In addition, FINTRAC looks to improve its STR examination

methodologies, and to use strategic intelligence to enhance its ability to detect unreported STRs. Moreover, FINTRAC is continuously improving its findings letters to the banking sector to provide examples of unreported STRs and demonstrate its expectations. Throughout all of these efforts, FINTRAC continues to engage with the sector to provide support.

*FINTRAC Determines Follow-up Action in the Banking Sector*

FINTRAC assessed the compliance of banks with other obligations. Examinations revealed that banks generally demonstrated challenges with respect to obligations related to conducting risk assessments. In addition, deficiencies related to the obligation to develop policies and procedures were identified in all examinations that assessed this compliance element.[1] This was mostly because the banks examined for this element

R6 (PII) The proper administration or enforcement of an Act [redacted] RC6

FINTRAC considered the findings of each examination and determined that

R6 (PII) The proper administration or enforcement of an Act [redacted]

**2. Real Estate Sector**

*FINTRAC Engages with the Real Estate Sector and Associations to Strengthen Compliance*

R6 (PII) The proper administration or enforcement of an Act [redacted] To assist reporting entities meet their obligations, FINTRAC dedicated significant effort to working with the sector in 2016-17. For instance, FINTRAC placed additional focus on working directly with some of the provincial and municipal real estate boards to raise awareness of key ML/TF issues.

The Centre met with the Toronto Real Estate Board to discuss compliance obligations and highlighted the potentially higher ML/TF risks associated with foreign buyers. FINTRAC also met with the Real Estate Board of Greater Vancouver and l'Organisme d'autoréglementation du courtage immobilier du Québec to discuss opportunities for more training, guidance and collaboration. At the meeting with the Real Estate Board of Greater Vancouver, FINTRAC committed to working with the Board to set up presentations for managing brokers to raise their awareness of the Centre's compliance and intelligence activities.

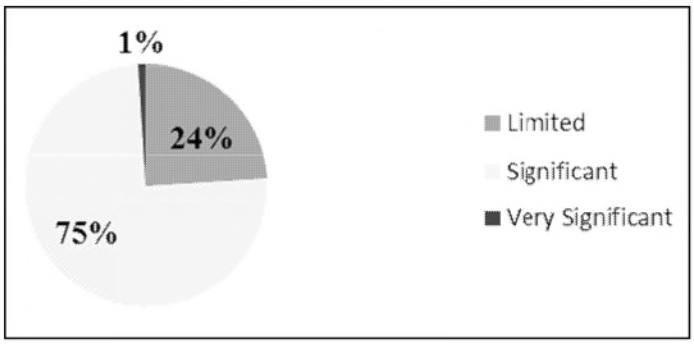
[1] As reporting entities are not all examined for the same obligations, examination findings of a given compliance element cannot be generalized across a sector.

FINTRAC also continued to work closely with [redacted] R6 (PII) The proper administration or enforcement of an Act RC6 [redacted] Moreover, in October 2016, FINTRAC published an updated risk-based approach workbook for the real estate sector. This workbook provides tailored risk based approach information specific to the sector to increase their understanding of their obligations.

*Examinations in 2016-17 Reveal Ongoing Non-Compliance*

FINTRAC prioritized the real estate sector in its examination strategy in fiscal year 2016-17 due to sector-wide vulnerabilities to money laundering. Last fiscal year, FINTRAC examined a total of 152 entities in this sector, which accounts for approximately 20% of all examinations. As shown in Figure 3, the overall level of non-compliance continues to be significant.

**Figure 3: Overall Level of Non-Compliance of Real Estate Sector Entities Examined in 2016-17**




FINTRAC examinations focused on brokerages in Vancouver and the Lower Mainland since this area's real estate market exhibits indicators congruent with money laundering risks identified in the *Assessment of Inherent Risks of Money Laundering and Terrorist Financing in Canada* (also known as the National Risk Assessment, or NRA), such as high numbers of luxury properties and concentration of foreign investment in the market. Real estate brokers and agents from these areas, as well as those from the Greater Toronto Area are part of the 2017-18 examination plan.

Since reporting entities in the real estate sector generally have lower reporting levels, the examinations focused on compliance program elements, client identification, record keeping and third-party determination obligations. A low number of reporting entities in the real estate sector were assessed as being compliant with obligations related to conducting a risk assessment (10%), conducting a two-year review of the compliance program (21%) record keeping (28%), and implementing policies and procedures (32%). However, more were assessed as being compliant with obligations pertaining to having designated compliance officers (96%), third party determination (97%), training (56%) and verifying the identity of clients (48%).

*Outstanding Regime Gaps in Covering Legal Professionals under the PCMLTFA*

Notwithstanding FINTRAC's efforts to improve compliance in this sector, important gaps remain with respect to the role that legal professionals play in real estate transactions. Financial institutions and legal professionals are also engaged in real estate transactions. However, as a result of a 2015 Supreme Court judgement, the legal profession (other than B.C. notaries) is not subject to the PCMLTFA. Therefore, the legal profession is not required to report transactions tied to real estate.

R6 (PII) The proper administration or enforcement of an Act

[redacted]

### 3. Casino Sector

*Examinations in the Casino Sector Reveal Improvements in Compliance*

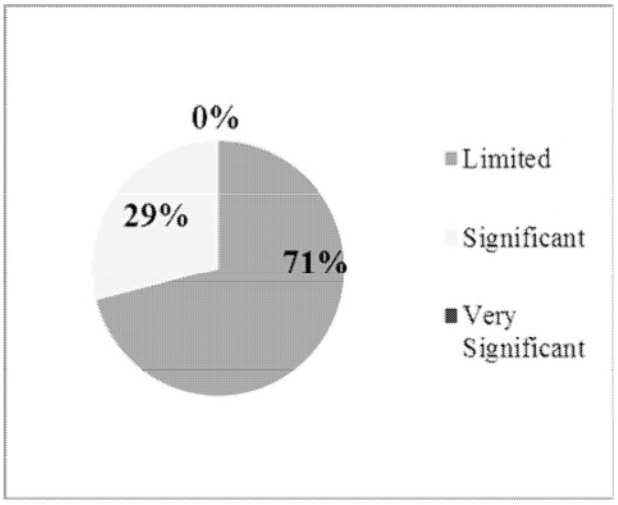
Seven casinos were selected for examination in 2016-17. Examination results highlighted in Figure 4 show that there was no case of very significant non-compliance in this sector, consistent with findings from the previous year. During these examinations,

R6 (PII) The proper administration or enforcement of an Act
R7 (PII) Protection of Federal-Provincial Relations

[redacted]

One of these was a large provincial casino lottery corporation committed to implementing measures to meet its obligations.

**Figure 4: Overall Level of Non-Compliance of Casinos Examined in 2016-17**




Although the sector generally demonstrates high levels of compliance, FINTRAC cited four of the seven examined casinos for the following deficiencies: incomplete risk assessments, issues related to training, ineffective implementation of enhanced measures that were not applied to high risk clients or that led to inconsistent results, insufficient or absence of written policies and procedures on certain requirements, and failure to conduct a two-year review of the compliance program.

FINTRAC has advised some of these casinos that they may be subject to follow-up examinations and were warned that similar deficiencies in future examinations could lead to further enforcement action, such as the issuance of an administrative monetary penalty.

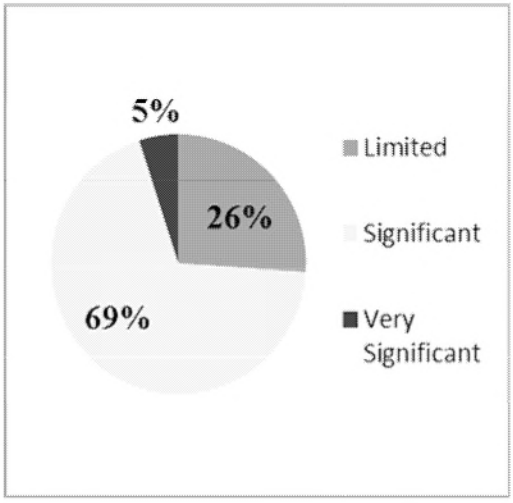
For two of the casinos, FINTRAC took follow-up action [redacted]
R6 (PII) The proper administration or enforcement of an Act

## 4. Money Services Business Sector

*Examinations of the MSB Sector Reveal Consistent Levels of Non-Compliance*

In 2016-17, FINTRAC conducted 110 examinations in the MSB sector. As illustrated in Figure 5, examinations in the last fiscal year revealed that only 5% of the examined entities had very significant non-compliance with AML/ATF obligations.

**Figure 5: Overall Level of Non-Compliance of MSBs Examined in 2016-17**




FINTRAC is seeing improvement in the sector's compliance with certain obligations. In fact, the number of MSBs assessed as compliant for the following obligations has increased compared to the previous fiscal year: obligations related to registering with FINTRAC (84%) (see Annex B for more details on FINTRAC's MSB Registry), training (54%), and instituting a two-year review of the compliance program (34%).

The only major decrease in compliance rates are related to electronic funds transfer report quality and volume: 36% of MSBs examined for EFT quality were assessed as being compliant compared to 49% in 2015-16, and 68% were compliant with reporting volume obligations (i.e., over reporting or under reporting), compared to 86% in 2015-16.

R6 (PII) The proper administration or enforcement of an Act
[redacted] A follow-up examination will be scheduled if concerns remain with respect to a reporting entity's compliance.

*FINTRAC Submits a Non-Compliance Disclosure on an MSB to Law Enforcement Following a Compliance Examination*

In the last fiscal year, FINTRAC made a non-compliance disclosure on an MSB. A non-compliance disclosure is made to law enforcement when there is extensive non-compliance with the PCMLTFA or little expectation of immediate or future compliance by the reporting entity. Although non-compliance with the Act can result in criminal or administrative penalties, both types of penalties cannot be issued against the same instances of non-compliance. In this case, FINTRAC assessed that a non-compliance disclosure was the most appropriate course of action based on examination results that revealed the MSB's extensive non-compliance with the Act.

The disclosure was produced by FINTRAC as a result of information included in a voluntary information record provided by law enforcement. The voluntary information record pointed to non-compliance of an MSB that was suspected of laundering proceeds from organized crime. FINTRAC assessed the level of risk associated with the MSB identified in this voluntary information record and found that there was a high risk of non-compliance. Subsequently, FINTRAC conducted a database examination review to verify if the MSB was in compliance with the PCMLTFA and determined that it had reasonable grounds to suspect that the information would be relevant to the investigation or prosecution of non-compliance under the PCMLTFA. As a result, FINTRAC issued a non-compliance disclosure to law enforcement.

## IV. EVOLUTION OF FINTRAC'S APPROACH TO COMPLIANCE

### A) Developments in the Administrative Monetary Penalties Program

FINTRAC has the legislative authority to issue administrative (or civil) monetary penalties to reporting entities that do not comply with the PCMLTFA. Since the administrative monetary penalty program came into effect in 2008, FINTRAC has issued 95 penalties.

Since July 2014, the Federal Court and the Federal Court of Appeal have rendered decisions on four penalty cases: *Homelife Experience Realty v. AGC*, 2014 FC 657; *Max Realty Solutions Ltd. v. AGC,* 2014 FC 656; *Kabul Farms Inc. v. HMQ,* 2015 FC 628 and *Max Realty Solutions Ltd. v. AGC*, 2016 FC 620. In all cases, the Courts found that the Director of FINTRAC's decisions were reasonable in concluding that violations had been committed; however, the Courts sent the penalty amount back to FINTRAC for redetermination and stated that FINTRAC must provide sufficient and comprehensive information on penalty amount calculations. In Kabul Farms, the Court also found that FINTRAC did not assess any actual harm that resulted from the reporting entity's non-compliance, and argued that a rigid formula does not take into account the specific circumstances in which the violation occurs.

In response, FINTRAC [R6 (PII) The proper administration or enforcement of an Act] The Centre made a number of changes to its administrative monetary penalties program to address issues of transparency on how FINTRAC calculates the amount of its penalties, including consideration of the harm done. To this end, FINTRAC sharpened its policy definition of harm done by tying the notion of "harm" directly to the objectives of the PCMLTFA and to FINTRAC's mandate. This gives FINTRAC the flexibility to articulate harm for each of the prescribed violations to account for the specific circumstances of each case and adapt the penalty calculation methodology accordingly. FINTRAC is also finalizing the documentation of

its new policies, rationale and methodologies for publication on its website. This will help address the Courts' findings regarding transparency by informing reporting entities of how FINTRAC calculates the penalty amount.

In addition, the Centre refined its guiding principles on the application of administrative monetary penalties. [redacted] The objective is to require reporting entities to take responsibility in understanding the underlying problems with their compliance programs, even after an examination is complete.

R6 (PII) The proper administration or enforcement of an Act

In the previous fiscal year, FINTRAC imposed its first administrative monetary penalty of $1.15 million on a bank (Manulife) that failed to report an STR. In addition to the ability to issue administrative monetary penalties, FINTRAC has, at its discretion, the authority to publicly name a reporting entity once an administrative monetary penalty is imposed and all avenues of review and appeal have been exhausted. In this case, FINTRAC decided to not publicly name the bank. This decision was based on the administrative nature of the violations, as well as mitigation measures that the bank took to address its client's activities, including: the identification of the client's account and the bank's engagement with Canadian and American law enforcement authorities in relation to the client's activities. Moreover, in making this decision, the Centre avoided a lengthy and often confidential court process and sent a timely message of deterrence to all reporting entities.

Although FINTRAC believes that this decision resulted in a strong message of deterrence to all reporting entity sectors, the Centre also acknowledges the public concerns that followed. The concerns raised related to the impact of this decision on the public interest, questions of fairness to other reporting entities that FINTRAC has publicly named, and questions regarding to the transparency of FINTRAC's compliance program.

In response, FINTRAC developed a proposal for the Department of Finance to strengthen the Centre's public naming policy by allowing it to publicly name a penalized reporting entity at an earlier stage of the process. The proposal aims to enhance the deterrence effect of an administrative monetary penalty by avoiding procedural delays in Court proceedings when a penalized reporting entity appeals the Director's decision. FINTRAC notes that there may be reputational impact for reporting entities that are named before Court proceedings have ended, where it is possible that the Court could overturn the

violations; therefore, it expects significant pushback from reporting entities, particularly the banking sector.

FINTRAC also developed and shared other proposals with the Department of Finance to strengthen the compliance program, including clarifying the notions of "harm done" and of prohibitions on disclosure in the legislation. The latter results from FINTRAC's commitment to improving transparency of its compliance program by proposing legislative changes that would prevent confidentiality orders on information in administrative monetary penalty Court proceedings. The Centre will continue to work with Department of Finance officials in support of these proposals and other initiatives that aim to enhance the compliance program.

### B) Changes to FINTRAC's Approach to Examinations

Since the establishment of FINTRAC's examination program, compliance officers have followed a methodology that consists of verifying a reporting entity's compliance against its obligations as set out under the PCMLTFA, and of determining instances of non-compliance. Over several years, FINTRAC's approach to examinations has undergone a gradual shift. This shift is characterized by moving away from the simple measuring of technical compliance (an audit, or" check-box" approach) and toward an evaluation of the impact of non-compliance to Canada's AML/ATF regime, taking into account the totality of the circumstances (an assessment approach). The approach aims to increase transparency of the examination process, for example, by sharing more information with reporting entities on examination findings and on how penalties are calculated.

With this approach, FINTRAC intends to place more emphasis on examining a reporting entity's overall effectiveness in complying with the PCMLTFA and associated Regulations, rather than on conducting a granular audit of all its obligations. FINTRAC will also consider in its assessment the reporting entity's efforts toward applying mitigation measures, and whether there were aggravating factors or circumstances. This will help to better assess the impact of the non-compliance and facilitate decision-making on the enforcement action to take in order to address the deficiencies or issues identified.

## V. CONCLUSION

The 2016-17 fiscal year was marked by FINTRAC's effort to operationalize a renewed approach to compliance. This approach is reflected in FINTRAC's significant engagement with reporting entities to encourage them to take responsibility for their compliance activities and to understand the role they play in the fight against ML/TF.

The assessment approach is also central to FINTRAC's efforts to strengthen its administrative monetary penalties program and to ensure continued fairness and

transparency in all of its compliance activities. [redacted]
R6 (PII) The proper administration or enforcement of an Act

# ANNEX A: EXAMINATION STRATEGY FOR FISCAL YEAR 2016-17

FINTRAC's examination strategy begins with assessing reporting entity sector risks. This risk assessment is based on the strategic and tactical intelligence developed by the Centre, risks identified in the NRA, and other factors such as a reporting entity's compliance history. Individual reporting entities are then selected for examination based on their risk profiles. Methods are put in place to ensure that FINTRAC examines a comprehensive selection of reporting entities that represent various compliance risks and that are of the highest concerns. Table 1 provides an overview of the examination methods used for each sector in the examination strategy of 2016-17.

**Table 1: Examination Strategy by Reporting Entity Sector in 2016-17**

| Sector | # of reporting entities examined | Selection method (exam strategy) |
|---|---|---|
| Banks | 9 | R6 (PII) The proper administration or enforcement of an Act [redacted] |
| Casinos | 7 | |
| Credit union Caisse populaires and financial services cooperatives | 113 | |
| MSB | 110 | |

[2] This selection method is used to select entities from sectors without a risk model using any risk information available.
[3] Concurrent and joint assessments are conducted with OSFI. In concurrent examinations, both agencies issue separate findings letters, whereas a joint findings letter is issued in the case of joint assessments.
[4] Used to ensure sector coverage by examining the largest entities in an activity sector.
[5] Used to rank reporting entities based on risk model.
[6] Random selection of reporting entities examined to test and validate the risk model.
[7] Used to evaluate the entity's change in behaviour following a previous examination.

| | | |
|---|---|---|
| Real estate | 152 | R6 (PII) The proper administration or enforcement of an Act |
| Securities | 69 | |
| DPMS | 62 | |
| Trust and loan | 7 | |
| BC notaries | 73 | |
| Accountants | 2 | |
| Life insurance | 57 | |

[8] Theme-based examinations are selected by headquarters for projects or information sources. For example, R6 (PII) The proper administration or enforcement of an Act challenges in brokerages dealing in luxury properties and foreign investment. These activities represent an indicator congruent with money laundering risks, as identified in the NRA.

R6 (PII) The proper administration or enforcement of an Act

## ANNEX B: MSB REGISTRY STATISTICS

As of March 2017, 850 MSBs were registered with the Centre. Under the PCMLTFA, MSBs are required to register with FINTRAC and must renew their registration biennially. As illustrated in Figure 6, there were 270 new MSB registrations and 330 renewals in 2016-17. When FINTRAC requires more details from MSBs, it may send clarification requests. Reporting entities are required to respond to these requests within 30 days. If the reporting entity fails to do so, it may be subject to a penalty, its registration may be denied, or its registration may be revoked. MSB registration can also be denied if the individual or organization is not eligible for registration. As shown the figure, there were 11 revocations in the last fiscal year, and zero registration denials.

**Figure 6: MSB Registry Statistics from 2015-16 and 2016-17**