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Submission to the Department of Finance Consultation Paper: Reviewing Canada's Anti-Money Laundering and Anti-Terrorist Financing Regime

I. Introduction

Coinsquare welcomes the opportunity to submit our comments on the paper issued for consultation by the Department of Finance (Finance) on February 7, 2018 (Consultation Paper), as part of Finance's review of the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (PCMLTFA) and its Regulations. We commend Finance's efforts to engage with stakeholders through meaningful consultations on the critical topic of combating money laundering and terrorist financing.

Our submission relates to Finance's proposal to modernize the anti-money laundering framework, and specifically, the issue of "de-risking" prevalent in the banking industry. As a FINTRAC-registered Money Services Business (MSB), we are directly affected by de-risking practices and applaud Finance for acknowledging the issue.

II. The De-Risking Issue

"De-risking" is a practice whereby financial institutions close accounts of or refuse service to clients or potential clients which the financial institution perceives to be high-risk. Since MSBs are generally viewed as high-risk, financial institutions are wary of engaging with them, and many are taking a wholesale approach by indiscriminately denying service to all MSBs. In highlighting this issue, Finance joins a growing list of regulators both within Canada and globally who recognize the challenge that de-risking presents to MSBs. Below we outline some of the consequences of de-risking.

III. Consequences of De-Risking

a) De-risking may be motivated by anti-competitive intentions

The Competition Bureau, in its recent FinTech Market Study, highlighted the unique issue faced by financial technology companies that are often direct competitors to the financial institutions upon which they rely. Although there can be legitimate reasons to refuse services to an MSB, the study points out that financial institutions are in the position to refuse banking services for competitive reasons. The UK's Financial Conduct Authority (FCA) also conducted a study into the trend of de-risking by UK banks. The FCA's study noted that banks are subject to competition law and should be mindful of the legislated prohibitions on anticompetitive agreements and abuse of market power when deciding to terminate relationships or decline new relationships. In particular, de-risking has become a problem in the blockchain industry, where financial institutions are blanket refusing banking services to registered MSBs without providing legitimate reasons for refusal of such services. This hinders the development of the Canadian blockchain industry forcing companies to move overseas and excludes Canadians from participating in a global economy.

b) De-risking is an incorrect application of the PCMLTFA

As the Consultation Paper states, a financial institution's obligation pursuant to the PCMLTFA is to limit its exposure, rather than eliminate it entirely, by taking a risk-based approach. The

expectation is that any such approach should be conducted on a case-by-case basis rather than by a wholesale refusal to engage with MSBs.

Other regulatory bodies discouraging the practice of indiscriminately refusing banking to MSBs include the US Financial Crimes Enforcement Network, which released a statement in 2014 outlining its expectations of banks, including that banks should treat MSBs like any other category of customer. The level of risk in every category will vary, and therefore MSBs should be treated on a case-by-case basis. Further, in a bulletin issued in 2016, the Office of the Comptroller of the Currency stated that financial institutions ought to take a risk-based and individualized approach rather than terminating entire categories of relationships.

Finally, as noted in the Consultation Paper, there is a requirement in the PCMLTFA to "know your customer," but financial institutions are at times operating under the mistaken belief that the requirement extends to the customers of the customer. A 2015 Financial Action Task Force (FATF) report on correspondent banking states that the FATF approach to de-risking is based on the FATF Recommendations which require financial institutions to identify, assess and understand their money laundering and terrorist financing risks, and implement AML/CFT measures that are commensurate with the risks identified. This report clarifies that the FATF Recommendations do not require banks to perform, as a matter of course, normal customer due diligence on the customers of their respondent banks when establishing and maintaining correspondent banking relationships.

A parallel can be drawn to MSBs when attempting to engage with Canadian financial institutions operating under a de-risking model. MSBs themselves are subject to the PCMLTFA and thus have their own AML/CTF regime in place, yet are challenged and denied by financial services providers under the guise that MSBs are high risk due to their unregulated nature, and are thus subject to enhanced due diligence to mitigate the higher risk. This has had the result of a duplication of PCMLTFA efforts, giving financial services providers the ability to levy ever increasing fees and obligations onto MSBs to maintain a business operating account.

Where financial services providers engage with MSBs, they appear to be operating with ever increasing overreach under the guise of enhanced due diligence, collecting excessive amounts of customer information on MSBs' clients' clients, potentially increasing consumer privacy and data protection risks, and going well beyond the scope intended by the FATF's recommendations and the letter and spirit of the PCMLTFA and Regulations.

c) De-risking undermines its own goal

The practice of de-risking purports to protect the global financial system. However, as the Department of Finance mentions in the Consultation Paper, the refusal to service MSBs may drive those transactions underground where they are less transparent to regulators and law enforcement agencies. For example, in the blockchain industry, MSBs who cannot access banking in Canada will use offshore financial institutions to gain access to banking, which results in clients' assets being at risk and not protected by Canadian financial institutions. It is therefore in the best interests of regulators and law enforcement agencies that MSBs have access

to bank accounts with legitimate financial institutions, since such channels facilitate the investigation of money laundering and terrorist financing.

IV. Coinsquare's Proposal

To address the de-risking issue, we propose the following:

1. If a financial institution denies banking services to an MSB or other entity that can reasonably be perceived as a competitor, the financial institution must provide the MSB or entity with a legitimate and detailed reason for the decision.
2. The approach taken by financial institutions when evaluating MSBs must not be a blanket refusal to engage; rather, each application for an account must be reviewed on a case-by-case basis.
3. If the Department of Finance deems items 1 and 2 insufficient to adequately curb de-risking practices, a mandate similar to the EU's revised Payment Services Directive should be considered. Article 36 of the Payment Services Directive requires that "payment institutions have access to credit institutions' payment accounts services on an objective, non-discriminatory and proportionate basis."

V. Conclusion

Coinsquare is grateful for the opportunity to comment on the Consultation Paper and would be pleased to discuss our comments with Finance in greater detail.