Virtual currency and Canada's anti-money laundering framework

大成 DENTONS

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This article is Part One of a three-part summary of the proposed amendments to the *Proceeds of Crime (Money Laundering) and Terrorist Financing* Regulations (PCMLTFA), announced by the Department of Finance on June 9, 2018. In Part One, we will discuss amendments relating to virtual currency, Money Services Businesses (MSB) and foreign MSBs. In Part Two, we will consider the amendments made to the Regulations to address money laundering concerns regarding open-loop prepaid cards. Finally, in Part Three, we will consider other notable amendments.

In 2014, the Federal Government announced its intention to include dealers in virtual currency within the definition of MSBs. Amendments to PCMLTFA were proposed along with the promise of regulatory changes to address emerging concerns that virtual (or digital) currency would provide new opportunities for money laundering and terrorist financing activities. The 2014 amendments added to the definition of MSB, "dealing in virtual currencies," however, those amendments have not yet been declared in force.

In the ensuing four years, there has been ample speculation regarding the state of the amended regulations. As cryptocurrencies, like Bitcoin and Ethereum, rapidly gained media attention and market capitalization, Canadian companies — many of which are FinTech startups — have begun establishing cryptocurrency trading platforms, and exchange and transfer services. Those companies have navigated regulatory uncertainty that has made it difficult to plan strategically. Future compliance costs are difficult to assess when an organization exists in a regulatory vacuum. Additionally, many companies involved in the cryptocurrency space have indicated they would welcome the legitimacy an expanded regulatory regime would bring. In the absence of regulatory amendments, many Canadian companies have chosen to implement their own compliance policies, which attempt to mirror those in place at traditional MSBs. Indeed, in an effort to establish banking relationships, these policies have been necessary from a business perspective. While the development of those policies is prudent, they are not sufficient and may not be robust enough to mitigate money laundering and terrorist financing risks in the cryptocurrency space.

Many in the cryptocurrency space will likely welcome the proposed regulatory amendments as representing an important step forward in recognizing cryptocurrency and other digital assets as a potentially legitimate means of transferring value between parties.

The amendments

While the original 2014 amendments considered the regulation of virtual currency dealers by amending the definition of "MSBs" to include dealing in virtual currencies, the 2018 amendments are broader and regulate the movement of virtual currency, regardless of the reporting entity that is involved. Accordingly, all reporting entities involved in virtual currency transactions will be impacted by these proposed amendments. This development helps ensure a more even regulatory playing field and signals an intention by the Department of Finance to regulate virtual currency on a functional basis, rather than focusing the regulatory burden on any one reporting entity.

Additionally, the proposed amendments extend the Regulations to foreign MSBs, the definition of which mirrors domestic MSBs. The requirements imposed on foreign MSBs are very similar to those imposed on domestic MSBs. They will have to register with the Financial Information and Transaction Reporting Centre.

The proposed amendments impact two Regulations made pursuant to the PCMLTFA: the STR Regulation and the TFR Regulation (General Regulation). While summarizing the details of the proposed regulatory text is beyond the scope of this article, it is helpful to highlight the key definitions and themes.

The new definitions

The proposed amendments add several new definitions to both the STR and General Regulation.
For the first time, the Department of Finance has proposed a definition for the term “virtual currency”:

> *(a) A digital currency that is not a fiat currency and that can be readily exchanged for funds or for another virtual currency that can be readily exchanged for funds; or*
>
> *(b) Information that enables a person or entity to have access to a digital currency referred to in paragraph (a).*

Building on that definition, is the definition of “virtual currency exchange transaction”:

> *An exchange, at the request of another person or entity, of virtual currency for funds, funds for virtual currency or one virtual currency for another*.

“Funds” are also defined as

> *(a) Cash and other fiat currencies, and securities, negotiable instruments or other financial instruments that indicate a title or right to or interest in them; or*
>
> *(b) Information that enables a person or entity to have access to a fiat currency other than cash.*
>
> *For greater certainty, it does not include virtual currency*.

Importantly, both amounts of virtual currency received as payment for mining transactions and nominal amounts of virtual currency transferred for the purposes of validating another transaction (or the transfer of information) are exempt from the proposed regulatory amendments.

The new obligations

As mentioned above, the proposed amendments impose varying obligations on all reporting entities, not simply MSBs.

Under the proposed regulatory amendments, reporting entities’ reporting obligations will be expanded to include suspicious transactions or attempted suspicious transactions involving virtual currency. Additionally, large virtual currency transaction reports will be required for amounts greater than CA$10,000. Financial entities, MSBs and foreign MSBs will be required to report the transfer or receipt of such transactions, while other reporting entities must report the receipt. Detailed records—“large virtual currency transaction records”—must also be maintained, which are substantially similar to the large cash transaction records reporting entities must maintain today.

Financial entities, MSBs and foreign MSBs will also be required to maintain other records relating to virtual currency transactions, including records for the transfer or receipt of CA$1,000 or more in virtual currency, and “virtual currency exchange tickets”, which contain extensive information regarding a virtual currency exchange transaction.

Additionally, financial entities, MSBs and foreign MSBs will be required to perform identity verification in the case of

transfers or exchanges of CA$1,000 or more in virtual currency. In the case of entities, they will also have to make a determination of beneficial ownership.

Registration and compliance regime

As with MSBs today, those dealing in virtual currency and foreign MSBs will have to register with the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC). Failure to do so may incur penalties. Additionally, foreign MSBs that do not comply will not be able to maintain banking relationships with Canadian financial institutions.

While existing registered MSBs are required to have a compliance program in place that meets the requirements of the PCMLTF regime, entities that deal in virtual currencies will either have to develop such a program or ensure their existing program meets the regulatory requirements. Among the obligations is the need to appoint a Compliance Officer, develop comprehensive policies and procedures regarding record-keeping and transaction reporting, and perform an appropriate risk assessment.

For FinTech startups, such a program may seem daunting, but it is an essential component to compliance with regulatory obligations. While a certain percentage of virtual currency transactions may remain beyond the reach of AML/TFA regulators around the world, regardless of various legislative amendments, attempts must still be made to mitigate the risks posed by money laundering and terrorist financing activities wherever possible.

Next steps

According to the Regulatory Impact Analysis Statement, the proposed amendments will be declared in force 90 days after the date they are signed. In the interim, stakeholders may submit comments to the Department of Finance.

Entities that deal in virtual currencies should begin the process of either reviewing or establishing their compliance program.

Want to know more?

You can read the full report here. For more information, please contact Tracy Molino.

Your Key Contacts

Tracy Molino
Counsel, Toronto
D +1 416 862 3417
tracy.molino@dentons.com