Virtual currency and Canada's anti-money laundering framework

July 11, 2019

This article is Part One of a three-part summary of the Department of Finance's 2019 amendments to Canada's *Proceeds of Crime (Money Laundering) and Terrorist Financing Regulations* (Finalized Regulations).[1] The Finalized Regulations pertaining to virtual currency dealers registering as MSBs, and complying with other legislative obligations, such as suspicious transaction reporting and implementing compliance programs, will be brought into force on June 1, 2020. Remaining virtual currency dealers' obligations stemming from the Finalized Regulation will come into force on June 1, 2021. The Finalized Regulations aim to address the weaknesses of Canada's anti-money laundering legislation. In Part One, we consider the amendments made in the Finalized Regulations regarding virtual currency, Money Services Businesses (MSB) and foreign MSBs. Part Two discusses the finalized amendments relating to open-loop prepaid cards. Part Three considers other notable amendments.

In 2014, the federal government announced its intention to include dealers in virtual currency within the definition of MSBs. Amendments to the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (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.

In ensuing years, the rise of cryptocurrencies like Bitcoin and Ethereum have captured the attention of financial markets, regulators and the media. Canada, in particular, has played a substantial role in the development of virtual currency technology and business. However, Canadian companies have been forced to navigate their use of virtual currencies through relatively uncertain regulatory waters. This regulatory uncertainty has made it difficult for Canadian companies to plan strategically. Accordingly, many companies involved in the cryptocurrency space have expressed they would welcome the legitimacy an expanded regulatory regime would bring.

In response to the lack of regulatory guidance, companies have attempted to mirror the compliance policies of traditional MSBs. Indeed, in an effort to establish banking relationships, similar policies have been necessary from a business perspective. However, while the development of compliance policies remains prudent, the traditional MSB policies do not sufficiently mitigate money laundering and terrorist financing risks when they are applied to the cryptocurrency space.

The following amendments represent an important step forward in establishing a more robust regulatory framework for the use of cryptocurrencies and other digital assets as a potentially legitimate means of transferring value between parties.

The amendments

In 2018, the Department of Finance released a set of proposed amendments to "help address and close the gaps that exist in Canada's AML/TF regime, including regulating new business models and technologies, and address new emerging risks". [2] The 2018 amendments broadened the 2014 regulations to include "dealing in virtual currencies" in

the definition of MSBs. The 2018 amendments aimed to regulate all reporting entities engaged in virtual currency transactions.

The 2019 Finalized Regulations include greater detail than the amendments proposed in 2018. The result is a more technologically tailored approach to the regulation of virtual currencies. 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 Finalized Regulations adopt much of the 2018 amendments by extending regulation to MSBs and other reporting entities. The amendments included the addition of foreign MSBs that offer services to Canadians. The requirements imposed on foreign MSBs are very similar to those imposed on domestic MSBs. Both foreign and domestic MSBs will have to register with **the Financial Information and Transaction Reporting Centre**.

The Finalized Regulations 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 Finalized Regulations are directed at several definitions included in the *Proceeds of Crime (Money Laundering) and Terrorist Financing Suspicious Transaction Reporting Regulations*.

The definition of "Virtual Currency" was changed quite dramatically from:

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).

To:

a. A digital representation of value that can be used for payment or investment purposes 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. A private key of a cryptographic system that enables a person or entity to have access to a digital representation of value referred to in paragraph (a). *(monnaie virtuelle)*

Importantly, the Finalized Regulation broadens the definition of virtual currency in subsection (a) to include all digital "**representations of value**", instead of the more contentious term, "currency", which many industry players argue to be inapplicable in certain circumstances. However, the 2019 definition also narrows the scope of "virtual currency" under subsection (b) to engage specific circumstances involving "a private key of a cryptographic system", rather than circumstances where "information" enables access. Combined, these two developments establish a more precise definition for virtual currency. However, the overall impact of the changes is difficult to predict, particularly given other changes that were made, such as including "a private key of a cryptographic system that enables a person or entity to have access to a fiat currency other than cash" in the new, revised definition of "funds."

Canada's Finalized Regulations differ from other jurisdictions in their approach to virtual currencies. Malta establishes a more narrow definition to reflect various use cases for transferring value digitally. In Malta, the term "virtual financial asset" means "any form of digital medium recordation that is used as a digital medium of exchange, unit of account, or store of value" [3], whereas Virtual Token means "a form of digital medium recordation whose utility, value or application is restricted solely to the acquisition of goods or services, either solely within the DLT platform on or in relation to which it was issued or within a limited network of DLT platforms". [4] Canada's definition is

distinguishable in that is aims to create an even regulatory playing field that applies to digital representations of value equally, regardless of the particular use case.

Alternatively, the European Union defines virtual currencies as “a digital representation of value that is not issued or guaranteed by a central bank or a public authority, is not necessarily attached to a legally established currency and does not possess a legal status of currency or money, but is accepted by natural or legal persons as a means of exchange and which can be transferred, stored and traded electronically”.[5] This approach is similar to that in Canada, but perhaps more broad in that it excludes the notion of a private key and cryptographic system.

The definition of “funds” was also amended from:

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.

To:

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. A private key of a cryptographic system that enables a person or entity to have access to a fiat currency other than cash.

This definition narrows the scope of “funds” under subsection (b) to engage specific circumstances involving “a private key of a cryptographic system”, rather than circumstances where “information” enables access.

The New Obligations

Under the Finalized Regulations, reporting entities’ obligations are expanded to include reporting of suspicious transactions or attempted suspicious transactions involving virtual currency. 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”[6] —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

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.

For more information about virtual currency and Canada's anti-money laundering framework, please contact Tracy Molino or another member of Dentons' Banking and Finance group.

A special thank you to Noah Walters and Cameron Teschuk (summer students) for their assistance with this article.

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1. *Regulations Amending Certain Regulations Made Under the Proceeds of Crime (Money Laundering) and Terrorist Financing Act, 2019* [*Finalized Regulations*].↩
2. Canada, Department of Finance, *Regulations amending Certain Regulations Made Under the Proceeds of Crime (Money Laundering) and Terrorist Financing Act, 2018*, June 2018 (Ottawa: Department of Finance, June 9, 2018).↩
3. *Virtual Financial Assets Act,* Malta, CAP. 590, online: http://www.justiceservices.gov.mt /DownloadDocument.aspx?app=lom&itemid=12872&l=1 at 7.↩
4. Ibid.↩
5. EC, *amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU* [2018] OJ L156/43 at Article1(2)(d).↩
6. For amounts equal to or greater than $10,000.↩

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