CHAMBER OF DIGITAL COMMERCE

September 7, 2018

Via Electronic Submission: fin.fc-cf.fin@canada.ca

Lisa Pezzack
Director General
Financial Systems Division
Financial Sector Policy Branch
Department of Finance
90 Elgin Street
Ottawa, Ontario
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RE: Comments of the Chamber of Digital Commerce on the Regulations Amending Certain Regulations Made under the Proceeds of Crime (Money Laundering) and Terrorist Financing Act, 2018 (the "Proposed Regulations") published in the Canada Gazette on June 9, 2018.[1]

Dear Ms. Pezzack:

The Chamber of Digital Commerce (the "Chamber") welcomes the opportunity to submit these comments in response to the Proposed Regulations. The Chamber is the world`s largest trade association representing nearly 200 members in the digital asset and blockchain industry, including members located in Canada. Our mission is to promote the acceptance and use of digital assets and blockchain technologies, and we are supported by a diverse membership that represents the industry globally.

Through education, advocacy, and close coordination with policymakers, regulatory agencies, and industry across various jurisdictions, our goal is to develop a pro-growth legal environment that fosters innovation, job creation, and investment. We represent the world's leading innovators, operators, and investors in the digital asset and blockchain technology ecosystem, including leading edge start-ups, software companies, global IT consultancies, financial institutions, insurance companies, law firms, and investment firms. Consequently, the Chamber and its members have a significant interest in the Proposed Regulations and specifically in the regulation of those deemed to be "dealing in virtual currency."

The Chamber recognizes that modernizing anti-money laundering ("AML") laws to counter money laundering and terrorist financing is an important goal. This objective is particularly important in light of the advances in technology that enable people and industries to engage in

[1] Canada Gazette, Part I, Volume 152, Number 23: Regulations Amending Certain Regulations Made Under the Proceeds of Crime (Money Laundering) and Terrorist Financing Act, 2018 (June 9, 2018): http://www.gazette.gc.ca/rp-pr/p1/2018/2018-06-09/html/reg1-eng.html.

commerce in new and important ways. Nevertheless, as noted by the Competition Bureau in its report, *Technology-led Innovation in the Canadian Financial Services Sector,*[2] while regulatory frameworks applicable to the financial services and banking sectors are unquestionably important in safeguarding consumers and mitigating risks to the financial system as a whole, they can inadvertently deter innovation and the competitive benefits that follow. In this regard, the Proposed Regulations raise a number of concerns that threaten to chill innovation and reduce competition in the financial services sector in Canada. We describe these in more detail below.

1. Definitions

The Proposed Regulations define "virtual currency" as follows:

> *(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).*

While the Chamber is supportive in principle with appropriate regulation of certain activities involving virtual currencies, the concept of "virtual currencies" as set out in the Proposed Regulations is not clearly articulated. As a result, the definition increases the likelihood of marketplace confusion, ineffective regulation, and other unintended consequences for innovation in digital currencies and digital economies generally.

Specifically, the definition essentially says virtual currencies are digital currencies that can be readily exchanged for funds or another readily exchangeable virtual currency. They also provide an alternative for any information enabling access to digital currencies. Together, these two broad, imprecise concepts could lead to a wide variety of digital tokens and ancillary technology service providers being deemed to be dealing in "virtual currency" simply because of this regulatory uncertainty.

To date, it is more common to see descriptions of virtual currency limited to its function as a medium of exchange. For example, the United States uses the term "convertible virtual currency" to describe "a medium of exchange that operates like a currency in some environments, but does not have all the attributes of real currency. In particular, virtual currency does not have legal tender status in any jurisdiction."[3] It is considered convertible when it "either has an equivalent value in real currency, or acts as a substitute for real currency."[4] The Financial Action Task Force ("FATF") uses the term "virtual currency" as "a digital representation of value that can be digitally traded and functions as (1) a medium of exchange; and/or (2) a unit of account; and/or (3) a store of value, but does not have legal tender status … in any jurisdiction."[5] The introduction of a new definition that does not offer any additional clarity and rather creates new, more broad, criteria, serves to confuse an industry that operates

[2] Technology-Led Innovation in the Canadian Financial Services Sector (Dec. 14, 2017): http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/04322.html.
[3] FIN-2013-G001, Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies (Mar. 18, 2013): https://www.fincen.gov/sites/default/files/shared/FIN-2013-G001.pdf.
[4] Ibid.
[5] FATF Report: Virtual Currencies, Key Definitions and Potential AML/CFT Risks (June 2014): http://www.fatf-gafi.org/media/fatf/documents/reports/Virtual-currency-key-definitions-and-potential-aml-cft-risks.pdf.

globally and therefore must accommodate each country's rules when applicable. Thus, the scope of any definition should be limited to regulating the function as a currency and exclude non-currency uses and services that are ancillary to transfer of virtual currency, such as digital tokens or assets that do not function as currencies as well as providers of third-party software services such as multi-signature services.

Further, the term "readily exchangeable" is not defined. Does "readily exchangeable" mean that it has an equivalent value in fiat currency or that it can be digitally traded? These descriptions may not be adequate now that the proliferation of tokens and trading platforms means that some virtual currencies may be traded on some exchanges and not others, or for digital assets that do not function as currencies.

Recommendation: Appreciating that virtual currencies and the digital economy are global, as opposed to national, the Chamber urges the Government of Canada to closely align its definition of "virtual currency" to current global standards and definitions. The introduction of a new definition that does not offer any additional clarity and understates the attributes of virtual currency serves to confuse an industry and marketplace that operates globally in present day. Further, what is "readily exchangeable" should be narrowly defined to capture only those entities that serve an actual exchange function, and not include (or specifically exclude) service providers that are ancillary to this function (such as multi-signature services) as well as digital tokens that do not function as a currency.

Based on the foregoing, the Chamber encourages the Department to consider providing more clarity to the definition of "virtual currency" in a focused way to ensure consistent regulation of the industry worldwide and encourage adoption in Canada, rather than deter it with uncertain or inconsistent applicability.[6]

2. Dealing in Virtual Currency

Section 5(h) and 5(h.1) of the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (the "PCMLTFA"), once in force, will provide for a new category of money services business - those that provide the services of "dealing in virtual currencies," as defined in the Proposed Regulations.

In that regard, the Chamber is concerned that the Proposed Regulations do not in fact define or provide any provisions in respect of what "dealing in virtual currency" entails. The term "dealing" is not defined nor is the phrase "dealing in virtual currencies." While there is draft regulatory guidance that provides some insight into how the phrase "dealing in virtual currencies" may be interpreted by the Financial Transactions and Reports Analysis Centre of Canada ("FINTRAC"), we believe that this is more properly a concept that should be specified in the legislation itself and not left to regulatory guidance. We also believe that the concept of "dealing in virtual currencies" should be linked to principles of custodianship over virtual currencies, such as the exchange, transfer, and storage of virtual currency on behalf of third parties, rather than those

[6] We understand that the FATF will be developing a report on virtual currencies to be published in the near future. While we do not yet know what those final recommendations will be, they will be a resource to government authorities worldwide. Given the importance of this report and the value of aligning regulations to current practices and marketplace advancements, as clearly prioritized by the Government, and as set out in the Preface of the Department of Finance's report "Reviewing Canada's Anti-Money Laundering and Anti-Terrorist Financing Regime" (February 2018), this development may help authorities gain the benefit of those recommendations to develop comprehensive, consistent regulation globally, rather than to develop something that may require refinement in the near future.

companies that may provide services related to virtual currency but do not provide custodian services. Clarity in the scope and application of these provisions is critical to encourage business innovation and efficiencies so that members of the virtual currency ecosystem can readily understand the obligations and legal framework to which they are or may be subject.

Recommendation: The definition of "dealing" in virtual currencies should be specified in the regulations, focused on activities that typically constitute money transmission or similar activities, and be written to exclude ancillary services that should not be captured by AML rules.

3. Recordkeeping Requirements

The Chamber understands the need for recordkeeping requirements applicable to clearly defined activities in respect of certain virtual currency transactions that exceed specific thresholds. Nevertheless, the Chamber is concerned with numerous recordkeeping requirements referencing "every other known detail that identifies the transaction" in the Proposed Regulations *(see, for example*, definition of *virtual currency transaction ticket,* subsection (h); virtual currency records, subsections 36(g)(viii), 36(h)(x); Schedule 4 *Report with Respect to Receipt of Virtual Currency,* Part B, item 9(e)).

The Chamber believes that a recordkeeping requirement that imposes a standard of "every other known detail" is unreasonably broad and open-ended. Such a requirement not only gives rise to privacy and cybersecurity concerns, which the Government has stated are a priority,[7] but also does not recognize the substantial costs imposed on regulated entities in collecting, storing, and protecting large amounts of data. A focus on collecting as much information as possible, particularly in a digital environment, pays inadequate attention to risk which is not in keeping with a risk-based approach as recommended by the FATF. Rather, financial institutions should be focused on obtaining high quality data rather than high quantity data.

The Chamber understands that the Privacy Commissioner of Canada, in appearing before the House of Commons' Standing Committee on Finance for its statutory review of the PCMLTFA, had recommended that a risk-based approach be adopted in order to minimize the risk of over-collecting and retaining the financial and personal information of law-abiding individuals. The Chamber echoes this concern in respect of the recordkeeping requirements set out in the Proposed Regulations. Instead of expanding the amount of information that must be obtained, we respectfully suggest that the PCMLTFA be modernized to require only that information that is appropriate to identify and understand customers and their transactions so that institutions can recognize that a person is who they say they are, and that suspicious activity can be identified and reported in a timely manner. The quality of the information is the important objective, not the quantity.

Recommendation: The Chamber recommends the Government clearly define the fields of information required for recordkeeping that is commensurate with risk and does not leave open-ended obligations that could amass large amounts of irrelevant data.

4. Ongoing Monitoring

[7] Reviewing Canada's Anti-Money Laundering and Anti-Terrorist Financing Regime (Feb 7, 2018): https://www.fin.gc.ca/activty/consult/amlatfr-rpcfat-eng.asp.

In keeping with the principles underlying a risk-based approach, the Chamber supports a requirement for those regulated by the PCMLTFA to engage in a fluid and dynamic ongoing monitoring process. The Chamber is concerned, however, that the amendment in the Proposed Regulations that requires "frequent and extensive" ongoing monitoring, does not reflect a true risk-based approach.[8] Rather, it encourages formulaic monitoring that very likely will be overly prescriptive, accumulating excessive amounts of data to be stored, analyzed, and secured.

Consistent with current global norms and FATF standards, the Chamber believes that regulated entities should be able to determine the appropriate level of ongoing monitoring required based on its assessment of various risk factors. This is true even in heightened risk scenarios. The current regulations support this approach and allow regulated entities the ability to adopt proportionate controls and exercise a degree of subjective judgment to meet the risks associated with the product, service, and/or customer.

Recommendation: The Chamber recommends that the Government modify the requirement in the Proposed Regulations for "frequent and extensive" on-going monitoring and instead condition the extent of such monitoring on the institution's assessment of risk.

5. Suspicious Transaction Reporting Requirements

With respect to suspicious transaction reporting (STR) requirements, the new proposal is as follows:

> The person or entity shall send the report to the Centre within three days after the day on which measures taken by them enable them to establish that there are reasonable grounds to suspect that the transaction or attempted transaction is related to the commission of a money laundering offence or a terrorist activity financing offence.

The Chamber understands that STRs provide law enforcement with useful information and thus should be filed with FINTRAC on a timely basis. Nevertheless, a three (3) calendar day window does not provide regulated entities with adequate time to investigate facts and circumstances, determine if in fact alerted activity meets the criteria of suspicious behavior, complete the necessary detail in the reports, perform the requisite quality control and oversight of those reports, and then submit those reports to FINTRAC. This problem is compounded when the activity is alerted on a Wednesday, Thursday, or Friday, rendering the financial institution in a position of completing its investigative process and filing the reports in less than 3 business days. Such an approach encourages filing in every circumstance to avoid breach of the filing deadline, overloading FINTRAC with excessive reports that may have little or no utility to law enforcement. Such an expedited timeframe is not required by the FATF Mutual Evaluation Report of Canada and would appear to exceed any reasonable period in which to conduct an appropriate investigation of facts.[9] Alternatively, if the ability to investigate, assess, and make a determination is considered to be included in the phrase "establish that there are reasonable grounds to suspect," and the 3 day requirement is limited solely to the administrative act of

[8] Canada Gazette, Part I, Volume 152, Number 23: Regulations Amending Certain Regulations Made Under the Proceeds of Crime (Money Laundering) and Terrorist Financing Act, 2018 (June 9, 2018): http://www.gazette.gc.ca/rp-pr/p1/2018/2018-06-09/html/reg1-eng.html.
[9] FATF Anti-Money Laundering and Counter-Terrorist Financing Measures: Canada Mutual Evaluation Report (Sept. 2016): http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-Canada-2016.pdf.

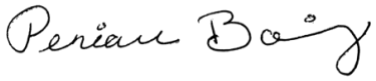
reporting, this time frame should at least be extended somewhat to allow for that administrative process and be modified to business days.

Recommendation: The Chamber suggests that the reporting period under the Proposed Regulations be revised to allow for a more feasible filing period, and at least no earlier than twenty (20) business days, as this is a more realistic time frame to provide regulated entities with the opportunity to prepare and finalize reports.

If the Proposed Regulations maintain this extremely expedited timeframe, the Chamber believes that the Proposed Regulations should make clear that the obligation to file a STR with FINTRAC is not triggered until the regulated entity completes taking measures that enable it to establish the reasonable grounds to suspect suspicious activity giving rise to an obligation to report it, and then provide 3 or more business days in which to conduct the administrative task of submitting the report.

We thank you for your consideration and would be pleased to answer any questions you may have.

Respectfully submitted,



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