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# Guideline

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**Subject: Deterring and Detecting Money Laundering**

**Category: Sound Business and Financial Practices**

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Money laundering continues to be a serious international problem that is receiving increasing attention as nations attempt to deal with issues such as organized crime and terrorism. Financial institutions, in particular, are at risk of being used by criminal organisations to launder money and by terrorist groups to facilitate the financing of their activities.

This guideline is intended to identify some of the steps that federally regulated financial institutions (FRFIs) should take to assist their compliance with the various legal requirements related to deterring and detecting money laundering and terrorist financing and, more generally, to minimize the possibility that they could become a party to money laundering and terrorist financing activities. Effective policies and procedures are essential to reducing the risk that facilitating money laundering and terrorist financing activities poses to FRFIs' reputations and operations. Both management and the boards of directors of FRFIs are responsible for the development of specific policies and procedures for deterring and detecting money laundering and terrorist financing as well as for ensuring the FRFI's adherence to those policies and procedures. OSFI also expects that institutions will be able to demonstrate, on request, that they have developed and implemented policies and procedures consistent with this guideline, and that staff are applying them as intended.

OSFI will work closely with the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC), and if section 97 (as currently numbered) of Bill C-17 (the *Public Safety Act, 2002*) comes into effect, will be able to share information concerning the policies and procedures that FRFIs have in place for complying with Part I of the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act (PCMLTFA)*. Recently adopted provisions of the PCMLTFA and the *Criminal Code* give FINTRAC and OSFI responsibility for dealing with issues related to the financing of terrorist activities. FINTRAC's objectives now include the detection, prevention and deterrence of the financing of terrorist activities, while OSFI has assumed the role of a central reporting point for the aggregate reporting requirements outlined in subsection 83.11(2) of the *Criminal Code*.

This guideline does not deal with OSFI's reporting requirements related to the financing of terrorist activities. However, OSFI posts on its Web site ([www.osfi-bsif.gc.ca](http://www.osfi-bsif.gc.ca)) lists of terrorist individuals and organizations, and will continue to receive reports from FRFIs as required by the *United Nations Suppression of Terrorism Regulations* or by subsection 83.11(1) of the *Criminal Code* in respect of entities listed in the *Regulations Establishing a List of Entities* made under subsection 83.05(1) of the *Criminal Code*. In addition, FINTRAC and a number of international organisations have published information related to terrorist financing activities. FINTRAC has also issued a guideline on Submitting Terrorist Property Reports. Nonetheless, FRFIs should keep in mind that the financing of terrorist activities is sometimes linked to money laundering. In addition, actual or suspected FRFI involvement in facilitating the financing of terrorist activities may expose FRFIs to risks similar to those related to the facilitation of money laundering.

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## I. Introduction and Background

This guideline applies to banks, authorized foreign banks in respect of their business in Canada (foreign bank branches or FBBs), companies to which the *Trust and Loan Companies Act* applies, cooperative credit associations subject to the *Cooperative Credit Associations Act*, and life companies or foreign life company branches to which the *Insurance Companies Act* applies. Collectively, they will be referred to in the guideline as federally regulated financial institutions (FRFIs). FRFIs should also ensure that subsidiaries having potential exposure to money laundering follow the guideline.

This guideline has been revised (from the 1996 version) to recognize actions taken both nationally and internationally to deal with money laundering. Key among the actions taken in Canada was the passage by the federal government of the *Proceeds of Crime (Money Laundering) Act* (PCMLA), which provided for the creation of the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC). This Act was subsequently expanded to address issues related to the reporting of terrorist financing activities and was renamed the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (PCMLTFA).

FINTRAC is an independent agency with a mandate to collect, analyze and assess information related to money laundering and terrorist financing activities, and to disclose certain information to law enforcement and intelligence authorities to assist in the detection, prevention and deterrence of these criminal activities. FINTRAC is also responsible for ensuring that FRFIs comply with the record keeping, reporting, and customer identification requirements set out in Part 1 of the PCMLTFA and the accompanying Regulations. More information on FINTRAC is available on its Web site at <http://www.fintrac.gc.ca/>.

Specific requirements related to the reporting of suspicious transactions are outlined in the *Proceeds of Crime (Money Laundering) and Terrorist Financing Suspicious Transaction Reporting Regulations* and in FINTRAC guidelines. The *Proceeds of Crime (Money Laundering) and Terrorist Financing Regulations* set out reporting and record keeping requirements for large cash transactions and international electronic funds transfers. Among other things, these regulations also outline requirements for client identification, retention of records, and the implementation of a compliance regime. Please refer to the FINTRAC Web site for copies of the PCMLTFA, Regulations, and FINTRAC guidelines, as well as for general information related to money laundering.

## II. Anti-Money Laundering Programs

### a. *Money Laundering Risks*

Financial regulators and international organizations recognize that money laundering is a serious problem that can pose a number of risks to financial institutions. The failure of a financial institution to implement policies and procedures to deter and detect money laundering can have a negative impact on its reputation and, consequently, on its ability to carry on business. Financial institutions that have international operations, that conduct business in off-shore jurisdictions, or that have customers that operate in those jurisdictions, need to be especially vigilant. The risks of doing business internationally have been highlighted by organizations such as the Financial Action Task Force on Money Laundering (FATF), which issues regular reports identifying jurisdictions that have deficiencies in their anti-money laundering regimes.<sup>1</sup>

FRFIs that fail to implement adequate measures in relation to the prevention of money laundering are exposed to potentially serious regulatory intervention initiatives, both domestically and internationally.

Consistent with the duty of care imposed by FRFI legislation on boards of directors and officers of FRFIs, standards of sound business and financial practices, and OSFI's Supervisory Framework, which focuses on identifying and mitigating risks, FRFIs should have policies and procedures related to deterring and detecting money laundering that are adapted to their individual situations. FRFIs should design these policies and procedures to ensure compliance with legal requirements related to deterring and detecting money laundering. The policies and procedures should include, for example:

- measures to identify the risk areas and the level of such risks within the institution;
- measures to control these risks; and
- a self-assessment program to determine the effectiveness of these measures.

To identify their level of exposure to potential money laundering activities and the associated risks, FRFIs must understand the nature of the risks associated with the different types of products and services that form different parts of their operations. These risks may vary depending on the nature of the operation and/or its location. The degree of potential exposure to money laundering should be understood, and the implementation of anti-money laundering measures should be flexible to reflect the features of different products and service locations, as well as changes in legal requirements. FRFIs should also have measures in place to ensure there

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<sup>1</sup> The FATF provides updates on the progress being made by jurisdictions named in its report and conducts reviews of additional countries and jurisdictions. Jurisdictions making sufficient progress in strengthening their anti-money laundering regimes are de-listed, while others may face various countermeasures if progress is insufficient. To obtain additional information on this report or on other FATF activities, FRFIs should refer to the FATF Web site located at <http://www.oecd.org/fatf>.

is ongoing assessment of the effectiveness of policies and procedures and to make changes as necessary.

*b. Board and Management Oversight*

Given their ultimate responsibility for the success of a FRFI's anti-money laundering programs, the board of directors and senior management must be strongly committed to ensuring that measures designed to address risks associated with money laundering are effective. However, front-line staff plays an essential role in implementing these measures and, therefore, must receive appropriate training to understand problems associated with money laundering, the financial institution's anti-money laundering policies, and the proper application of procedures.

It is essential that both the board of directors and senior management support anti-money laundering programs through all stages - design, approval, implementation, and review. The board and senior management should be directly involved in the approval and review stages.

*c. Policies and Procedures*

Senior management is responsible for the development of risk management programs and for keeping the board of directors adequately informed about these programs and their effectiveness. Policies and procedures to combat money laundering should form an integral part of a FRFI's overall compliance function. The following steps would form a sound basis for a comprehensive set of policies and procedures to deter and detect money laundering.

- i) Ensure that the FRFI has sufficient resources to comply with all legal requirements.
- ii) Name a "designated officer" responsible for corporate-wide anti-money laundering measures and who will report directly to senior management and the board of directors. The designated officer should ensure that each operating division of the FRFI having potential exposure to money laundering or the financing of terrorist activities appoints an officer to ensure that these divisions carry out policies and procedures as required. These officers should report regularly on compliance issues and the need for any revisions to policies and procedures. At each branch or unit that deals directly with the public, deposit-taking institutions should designate responsible employees (who need not be full time compliance officers) to ensure that anti-money laundering policies and procedures intended for these branches or units are applied.
- iii) Ensure that managers are aware of their overall compliance responsibilities, and, in particular, those linked to areas such as money laundering where non-compliance has the potential to cause significant damage to the FRFI's reputation.

- iv) Establish internal compliance reporting processes. (It should be noted that OSFI has issued guidance on legislative compliance management and that it refers to compliance requirements in both FRFI governing statutes (e.g., *Bank Act*) and in other legislation that affects FRFIs, such as the PCMLTFA.) The system of anti-money-laundering measures developed by FRFIs should be capable of demonstrating conformity with all anti-money laundering legal requirements. Further, the internal compliance reporting system should provide for regular reviews of compliance issues, for the documentation of such reviews, and for a process to address instances of non-compliance or any general areas of weakness identified. Where a FRFI believes the review has identified significant issues, it should review such issues with OSFI.
- v) Establish an annual self-assessment program designed to 1) evaluate the effectiveness of the FRFI's anti-money laundering procedures for identifying areas and types of risk, and 2) suggest corrective measures to address any weaknesses or gaps identified in the risk management systems. The annual self-assessment should include a report for senior management and the board of directors that summarizes the assessment's findings, including the scope of the review, the main elements of anti-money laundering policies and procedures, the level of adherence to them, and evidence that the policies and procedures comply with the PCMLTFA and its regulations, and with applicable FINTRAC and OSFI guidelines.
- vi) Establish a system of independent procedures testing to be conducted at least annually by the internal audit department, compliance department, or by an outside party such as the FRFI's external auditor. The scope of the testing and results should be documented, with deficiencies in anti-money laundering systems being reported to senior management and to the board of directors, and with a summary of steps taken (or to be taken) to address any deficiencies. The report should address areas such as: employee knowledge of legal requirements and the FRFI's policies and procedures; the FRFI's systems for client identification and for identifying and reporting suspicious and large cash transactions; and the associated record-keeping system.
- vii) Ensure that appropriate employees are given sufficient training. This should include knowledge of the FRFI's anti-money laundering policies and procedures, the techniques used by criminals to launder funds through financial institutions, and the current anti-money laundering legislation and regulations.

*d. Customer Identification*

Comprehensive customer identification policies and procedures can greatly reduce the risk of exposure to money laundering and should form a key part of an anti-money laundering program. The importance of customer identification has been recognized by a number of international bodies such as the FATF and the Basel Committee's Working Group on Cross-Border Banking. The International Association of Insurance Supervisors (IAIS) has also issued anti-money laundering guidance that highlights the importance of customer identification issues.

In October 2001, the Basel Committee released a final version of its paper entitled *Customer Due Diligence for Banks*. The paper sets out minimum standards for the development of appropriate practices in this area. OSFI believes that the customer due diligence standards identified in this paper represent a sound basis for ensuring that FRFIs have adequate “know your customer” controls and procedures in place. OSFI encourages FRFIs to familiarize themselves with the standards outlined in the paper and to implement these standards in a manner appropriate to the size, complexity, and nature of the institution’s business activities.<sup>2</sup> The paper is available on the BIS Web site (<http://www.bis.org>) and on OSFI’s Web site (<http://osfi-bsif.gc.ca>).

The IAIS approved the final draft of its *Anti-Money Laundering Guidance Notes for Insurance Supervisors and Insurance Entities* at its January 2002 Continued General Meeting. The document, which is available from the IAIS website (<http://www.iaisweb.org/>), pays particular attention to the need for verification of individuals involved in insurance contracts or other business being offered by the insurance entity. Life insurance entities should familiarize themselves with this document, as it provides a strong summary of key elements of an anti-money laundering program from an insurance entity perspective. The guidance notes, and especially those related to customer verification procedures and know your customer standards, can be used by life entities to assist in the development of their anti-money laundering programs.

FRFIs should be aware of the specific requirements related to customer identification set out in the PCMLTFA and the associated Regulations. Both the PCMLTFA and the Regulations are available from the Department of Justice Web site (<http://Canada.justice.gc.ca>). Note that the Regulations cover not only “the person standing in front of you,” but also third parties, trusts, corporate customers, individuals, partnerships, and unincorporated associations.

When developing customer identification, acceptance, and monitoring policies and procedures, FRFIs must be particularly vigilant with respect to situations or types of transactions where customer identification is more difficult. Examples include wire transfers (particularly those from overseas jurisdictions and from non-customers and non-correspondent banks), or pass-through accounts at FRFIs that are opened by foreign institutions to allow their customers to conduct business in Canada. The Basel Committee paper noted above provides a number of additional examples where customer identification can be more difficult and that may require enhanced vigilance.

FRFIs are expected to establish policies and procedures that, at a minimum, meet applicable legal requirements. However, FRFIs may establish internal policies and procedures that go beyond specific legal requirements or that take into account the business environment and activities specific to the institution. These policies and procedures should be formally documented. Not only will this assist OSFI and FINTRAC, it will also enhance a FRFI’s internal compliance function and the overall effectiveness of its policies and procedures.

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<sup>2</sup> Taking into account the particularities of each industry sector, OSFI will consult with industry associations regarding the manner in which the industry will implement the standards from the Committee’s paper.

### III. Review by the Office of the Superintendent of Financial Institutions

As part of its risk-based supervisory program, OSFI plans to review the adequacy of FRFIs' anti-money laundering policies and procedures, and their implementation, to ensure that FRFIs are taking appropriate steps to address money laundering activities and associated risks. OSFI may share results of these reviews with FINTRAC<sup>3</sup>, as they relate to compliance with Part 1 of the PCMLTFA. FRFIs should be prepared to provide information or material on money laundering deterrence and detection procedures to OSFI personnel when they are conducting an on-site review and, upon request, at any other time. (Note: additional information related to the items below can be found in Section II(c).) Material that may be examined would include, but would not necessarily be limited to:

- i) board-approved policies on anti-money laundering and related procedures;
- ii) in the case of deposit-taking institutions, a listing (produced upon request) of customers for whom the deposit-taking institution has chosen not to report large cash transactions as provided for by the transaction reporting exemptions set out in the PCMLTFA Regulations;
- iii) in the case of deposit-taking institutions, a description of how cash transactions over the threshold established by the institution's anti-money laundering procedures are recorded and reported;
- iv) in the case of life insurance companies, a description of how transactions over the threshold established by the institution's anti-money laundering procedures are recorded and reported;
- v) the name of the officer designated responsible for the institution's overall money laundering deterrence and detection procedures;
- vi) a description of the frequency and type of reporting to the officer and by the officer to senior management and the board;
- vii) electronic or paper evidence (could include FINTRAC confirmation of report filings) of all suspicious transaction, large cash transaction, electronic funds transfer, and other reports made by the institution pursuant to its reporting obligations;
- viii) evidence of a summary report to senior management in respect of suspicious transactions reports and large cash transaction reports that were made to FINTRAC;
- ix) documented evidence of system tests undertaken to confirm the appropriate functioning of the entity's anti-money laundering policies and procedures; and
- x) self-assessment reports to senior management and the board of directors.

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<sup>3</sup> In accordance with section 97 of Bill C-17 (the *Public Safety Act, 2002*) - passage of the Bill is pending.

## Reference Web Sites

The following is a list of organisations and their Web sites where additional information may be obtained regarding the prevention of money laundering. Many of the sites provide search engines that can be of assistance in obtaining helpful documentation.

### Domestic Organisations

Office of the Superintendent of Financial Institutions (OSFI)  
<http://www.osfi-bsif.gc.ca/>

Financial Transactions and Reports Analysis Centre of Canada (FINTRAC)  
<http://www.fintrac.gc.ca/>

### International Organisations

Bank for International Settlements (BIS)  
<http://www.bis.org/>

Financial Action Task Force on Money Laundering (FATF)  
<http://www1.oecd.org/fatf/>

International Association of Insurance Supervisors (IAIS)  
<http://www.iaisweb.org/>

Board of Governors of the Federal Reserve System (Federal Reserve)  
<http://www.federalreserve.gov/>

Office of the Comptroller of the Currency (OCC)  
<http://www.occ.treas.gov/>

Financial Crimes Enforcement Network (FinCEN)  
<http://www.treas.gov/fincen/>

U.K. Financial Services Authority (FSA)  
<http://www.fsa.gov.uk/>

Australian Transaction and Reports Analysis Centre (AUSTRAC)  
<http://www.austrac.gov.au/>