

## Canada: Consultation on AML/ATF Regime - Wide Implications for Digital Assets

### In brief

On 7 June 2023, the Department of Finance issued a public consultation contemplating certain changes to Canada's anti-money laundering and anti-terrorist financing ("AML/ATF") regime (the "**Consultation Paper**"), including proposals affecting virtual currency, digital assets, and technology-enabled finance in Canada.

The consultation paper can be accessed [here](#) and submissions may be made up to 1 **August 2023**. We invite you to reach out to us and discuss how the issues could affect your business.

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### The Consultation

Canada's AML/ATF regime is established under several statutes, including the **Proceeds of Crime (Money Laundering) and Terrorist Financing Act** (the "**Act**"), its associated regulations, and the **Criminal Code**. This year, a Committee of Parliament will conduct a Parliamentary Review of the Act, as required every five years under the Act. To support the review, the federal government published the Consultation Paper.

We summarize below the key points highlighted by the Consultation Paper on **virtual currencies, digital assets, and technology-enabled finance**, as well as the specific questions the Consultation Paper seeks comments on.

#### 1. **Proposed Legislative Changes under the Budget Implementation Act, 2023**

In the proposed Canadian federal budget for 2023-2024, a number of amendments concern digital assets and their implications for AML/ATF. Specifically, the budget announced the federal government's intention to:

- Amend the **Criminal Code** to give law enforcement the ability, based on prior judicial authorization, to seize digital assets that may be confiscated as the proceeds of crime;
- Strengthen the registration framework for money services businesses ("**MSB**") to prevent their abuse; and
- Criminalize the operation of unregistered MSBs, in addition to currently available penalties for non-compliance under the Act which include administrative monetary penalties.

Currently, dealers in virtual currency, including those offering both virtual currency exchange services and virtual currency transfer services, are required to register as an MSB (both domestic and foreign) with FINTRAC under the AML/ATF regime. In addition to the requirement to register, MSBs must abide by a number of reporting requirements to FINTRAC. As a result of the proposed legislative changes to the **Criminal Code**, entities providing virtual currency dealing services in Canada who do not register with FINTRAC may be subject to criminal penalties under the **Criminal Code** in addition to administrative monetary penalties issued under the Act. It will be incumbent on entities providing virtual currency dealing services in Canada, as defined by the AML/ATF regime, to register with FINTRAC as soon as possible to avoid these consequences.

## 2. Criminal Justice Measures to Combat Money Laundering and Terrorist Financing

The Consultation Paper seeks feedback on whether additional amendments to the **Criminal Code** are required to respond to challenges relating to digital assets.

Key topics for potential changes to Canada's **Criminal Code** are:

- **Blockchain Records:** Given the generally immutable nature of blockchain records, there is interest in their evidentiary role in proving transactions between parties and the timing of particular events. The **Canada Evidence Act** establishes certain rules of evidence in court proceedings, and includes a number of provisions that may be relevant in relation to blockchain records, including in relation to books and documents and admissibility.
- **Production of Information Related to Digital Assets:** Many cryptocurrency users rely on centralized exchanges to maintain and manage their cryptocurrency holdings. These centralized exchanges share many characteristics with conventional financial institutions that provide financial services. It may be necessary in the course of an investigation to obtain information from a centralized exchange that is similar to information that may be obtained through **Criminal Code** production orders. The Consultation Paper seeks feedback on whether existing production order provisions in the **Criminal Code** can apply to data held by centralized exchanges, or whether an amendment is needed to provide this effect.
- **Decentralized Services:** Decentralized financial services typically consist of financial products and services that operate on decentralized platforms using blockchains to record and share data. As decentralized exchanges operate through automated protocols, they can present challenges in the investigation of crime such as finding the relevant/proper entity upon which judicial authorizations to disclose information or restrain property may be served.

## 3. AML/ATF Regulatory Framework Respecting Virtual Currency, Digital Assets, and Technology-Enabled Finance

The Consultation Paper notes that while developments in financial technologies, such as virtual currencies, digital assets, and technology-enabled finance foster beneficial innovation and improved products and services for Canadians, they may also pose important money laundering and terrorist financing ("**ML/TF**") risks. To advance Canada's commitment to its risk-based approach to combatting ML/TF, the Consultation Paper seeks feedback to determine what, if any, government intervention is appropriate and would be effective to prevent these technologies from being used by bad actors to perpetuate ML/TF.

Previously, the Department of Finance and FINTRAC published risk assessments that determined that the inherent risks posed by virtual currencies are high, given their ease of access, anonymity, transferability outside of nationally regulated sectors, and their prevalent use in cybercrime. Concerns have been voiced that sanctioned actors are co-opting virtual currencies to evade Canada's sanctions regime.

Accordingly, the Department of Finance is currently looking closely at AML/ATF risks involving new technologies including

- Crypto-mixers and Crypto-tumblers
- Decentralized Finance (DeFi)
- Non-Fungible Tokens (NFTs)
- Metaverse
- Fintech
- Privacy-Enhancing Coins
- Tokenized Assets

See the **Glossary** below for definitions of these technologies as defined in the Consultation Paper.

While the Consultation Paper notes that the AML/ATF Regime partners will continue to monitor these technologies to identify and mitigate evolving ML/TF risks in Canada, they are seeking feedback on the following questions that have wide implications for digital assets and Fintech more generally:

- Are there ML/TF risks posed by new financial technologies that are insufficiently covered or mitigated by the AML/ATF framework?
- What legislative and regulatory remedies could be used to address the risks posed by new fintech products or services (e.g., Anonymity Enhancing Coins (AEC)/Privacy Coins, crypto-mixers, DeFi)?
- Should reporting entities be prohibited from transferring (and receiving) virtual currencies to (and from) crypto-mixers/crypto-tumblers that are not registered with FINTRAC?
- What AML/ATF obligations are needed for organizations hosting a Metaverse or having a platform for MSB-like activity conducted through their technology?
- What AML/ATF requirements should be extended to fintechs that are currently not regulated? Which types of fintechs would be implicated?
- How can the government ensure that AML/ATF obligations for this sector are technologically neutral so that new technologies that pose AML/ATF risks are incorporated into the AML/ATF regime in a timely manner?

#### 4. Introduction of Exemptive Relief for Testing New Technologies

To respond to the evolving financial services sector and the novel risks of ML/TF, the Department of Finance is considering whether to allow FINTRAC to give limited short-term exemptive relief to reporting entities to allow testing of new technologies and methods to comply with AML/ATF obligations.

The Consultation Paper seeks public feedback on whether and how the government should amend the Act to allow FINTRAC to provide short-term exemptive relief to reporting entities to allow testing of new technologies and methods to comply with AML/ATF obligations.

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## Global Perspective

Several other jurisdictions are looking to address ML/TF risks associated with the increasing use of digital assets. As early as September 2022, the United States government released a series of reports aimed at the responsible development of digital assets in the United States. Hong Kong also **amended** its AML/ATF regime to introduce a new licensing regime for virtual asset services providers in June 2022, and more recently, the Central Bank of the U.A.E. published its "**Guidance for Licensed Financial Institutions on Risks Related to Virtual Assets and Virtual Asset Service Providers**" in February 2023.

Additionally, in June 2023, the Financial Action Task Force ("**FATF**"), the intergovernmental organization overseeing policy developments in ML/TF, released their **targeted update** on global implementation of the FATF Standards and responses to the emerging risks like DeFi and peer-to-peer transactions.

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## Glossary

The Department of Finance provides a list of definitions for the technologies referred to in the Consultation Paper.

- **Crypto-mixers and Crypto-tumblers:** Providers of online services to mix virtual currencies together from a variety of sources before transferring it to the designated receiver(s) to obfuscate the chain of transactions from the sender to receiver and enhance anonymity.
- **Decentralized Finance ("DeFi"):** DeFi commonly refers to the provision of financial products, services, arrangements, and activities that use distributed ledger technology to disintermediate and decentralize legacy ecosystems by eliminating the need to use the services of traditional financial intermediaries and centralized institutions. Currently, there is no generally accepted definition of "DeFi," or what makes a product, service, arrangement, or activity "decentralized", but most specialists would include decentralized cryptocurrency exchanges ("**DEX**") and decentralized autonomous organizations ("**DAO**"). As this technology grows, more decentralized financial tools are likely to appear.

- **Non-Fungible Tokens ("NFTs"):** Unique digital assets that are not interchangeable and are generally used as collectibles rather than for payment or investment purposes. They are frequently purchased using virtual currencies.
- **The Metaverse:** Generally refers to a virtual reality (which could be entirely virtual or a combination of real-world setting augmented by technology-enabled sensory input) accessed via the internet that allows users to interact digitally, including transact with virtual currencies and digital assets.
- **Fintech:** In general, fintech companies provide technology-enabled financial services, such as depositing cheques, offering credit, transferring money, hosting interest paying savings accounts, and paying bills.
- **Privacy-Enhancing Coins:** A type of virtual asset that seeks to provide its users greater anonymity than other types of virtual assets.
- **Tokenized Assets:** Digital representations of ownership in real-world assets, such as real estate, art, commodities, stocks, and securities, that are traded on blockchain-based platforms.

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