

FATF DOWNGRADES CANADA AS LESS COMPLIANT IN REGULATING NPOs VULNERABLE TO TERRORIST FINANCING

*By Terrance S. Carter, Nancy E. Claridge and Sean S. Carter**

A. INTRODUCTION

The Financial Action Task Force (“FATF”) published a report titled “Anti-money laundering and counter-terrorist financing measures: Canada” (the “2021 Report”) on October 1, 2021, which is the fifth mutual evaluation of Canada that the FATF has conducted concerning its compliance with the FATF Recommendations concerning anti-money laundering and anti-terrorist financing (“AML/ATF”) measures.¹ The previous FATF report (the “2016 Report”) was released on September 15, 2016, as reported in *Anti-Terrorism and Charity Law Alert No. 47*.² In the 2016 Report, Canada fared well in general, but was non-compliant in five recommendations. In the 2021 Report, Canada demonstrated improvement in many areas, but remained non-compliant with regards to Recommendation 25, which calls for transparency and beneficial ownership in legal arrangements. Most importantly for charities and not-for-profits, Canada was downgraded from compliant to partially compliant with regard to

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¹ “Anti-Money Laundering and Counter-Terrorist Financing Measures” (1 October 2021), online: *FATF* <www.fatf-gafi.org/publications/mutualevaluations/documents/fur-canada-2021.html>.

² Terrance S. Carter, Nancy E. Claridge, and Sean S. Carter, “FATF Evaluates Canada’s Anti-Money Laundering and Counter-Terrorist Financing Regime” (25 October 2016), online (pdf): *Carters* <www.carters.ca/pub/bulletin/charity/2016/atcchylb47.pdf>.

Recommendation 8, which requires the application of focused and proportionate measures to protect non-profit organizations (“NPOs”) from terrorist financing abuse.³

The FATF evaluates Canada’s policies, which cover aspects of AML/ATF for compliance with international standards. Many of the FATF’s Recommendations do not apply to charities and not-for-profits, but rather to financial institutions and designated non-financial business and professions. However, Recommendation 8, as noted above, applies to NPOs, which includes charities and not-for-profit organizations. In this regard, Canada’s downgrade to “partially compliant” status is a noteworthy change. This *Alert* examines the issues involved in Recommendation 8 and provides a brief overview along with other rating changes from the 2021 Report.

B. GENERAL OVERVIEW

1. Recommendation 8

There was a substantial review of Recommendation 8 in June 2016 to follow a more risk-based approach to NPOs, which helps to provide some context to Canada’s change in status. In commenting on Canada’s existing NPO outreach activities, the 2021 Report noted that these activities “seem to focus on charities with an international connection” – an approach which is “in line with risk” – nevertheless “there does not appear to be any outreach that addresses TF [terrorist financing] risks and vulnerabilities within the domestic context.” The 2021 Report also highlighted that there was room for improvement “to deepen awareness among NPOs in relation to TF [terrorist financing] risks and vulnerabilities,” though it noted that Canada is already in the process of updating that material.

Following the 2016 Report, Canada revised its National Inherent Risk Assessment (“NIRA”) and updated the NPO Sector review so that a different grouping of organizations was caught within the FATF’s definition of an NPO.⁴ The recent NIRA update identified that the terrorist financing risk to the NPO sector as a whole is high.⁵ In light of the risks, and since Canada’s risk mitigation efforts

³ “International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation” (June 2021), online (pdf): FATF <www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf>.

⁴ “Reviewing Canada’s Anti-Money Laundering and Anti-Terrorist Financing Regime” (7 February 2018), online: *Government of Canada* <www.canada.ca/en/department-finance/programs/consultations/2018/canadas-anti-money-laundering-anti-terrorist-financing-regime.html>.

⁵ *Ibid.*

are primarily focused on registered charities – which make up a significant portion, but not the entirety, of the NPO sector – the 2021 Report found “moderate deficiencies” in Canada’s risk mitigation efforts.

Despite the concerns raised by the 2021 Report that Canada should do more to comply with Recommendation 8, groups such as the International Civil Liberties Monitoring Group and the University of Toronto’s Institute of Islamic Studies have also raised concerns that Canada’s current risk mitigation efforts pertaining to charities and terrorist financing appear to result in undue targeting.⁶ The FATF recognizes that its standards may have unintended consequences, such as de-risking and undue targeting of NPOs. In a high-level synopsis, published October 27, 2021, the FATF concluded that the undue targeting of NPOs in the context of purported or real AML/ATF efforts may be related to poor implementation of the FATF’s risk-based analysis.⁷ Terrorist financing and risk remain an important and evolving discussion for charities and NFPs to follow.

2. Other Changes

The 2021 Report also contained several positive status updates regarding Canada’s compliance with FATF standards. Canada was re-rated largely compliant with respect to identifying and dealing with politically exposed persons, as per Recommendation 12 (Canada had previously been ranked non-compliant). The country was also re-rated as largely compliant with Recommendation 16, which addresses requirements for intermediary and beneficiary financial institutions to identify and follow up with cross-border electronic transfers of funds that contain inadequate originator information. Other areas where Canada was found to be more compliant include better practices with regard to:

- relying on customer due diligence reporting by third parties (Recommendation 17),
- prompt reporting of suspicious transaction reports (Recommendation 20),

⁶ See Tim McSorley, “The CRA’s Prejudiced Audits: Counter-Terrorism and the Targeting of Muslim Charities in Canada” (May 2021), online: *International Civil Liberties Monitoring Group* <iclmg.ca/wp-content/uploads/2021/06/Prejudiced-Audits-ICLMG-2021.pdf>; and Anver M Emon & Nadia Z Hasan, “Under Layered Suspicion: A Review of CRA Audits of Muslim-Led Charities” (2021), online: <www.layeredsuspicion.ca/>.

⁷ “High Level Synopsis of the Stocktake of the Unintended Consequences of the FATF Standards” (27 October 2021), online (pdf): *Financial Action Task Force* <www.fatf-gafi.org/media/fatf/documents/Unintended-Consequences.pdf>.

- customer due diligence and record-keeping requirements which apply to certain designated non-financial business and professions in certain circumstances (Recommendations 22 & 23), and
- assessing the money laundering or terrorist financing risks posed by new products, practices or technologies (Recommendation 15).

C. CONCLUSION

Charities and not-for-profits, particularly those that work in conflict zones, will want to carefully monitor the federal government's response to the 2021 Report by the FATF, especially in light of Canada's downgraded status of "partially compliant" for Recommendation 8. While the country's overall improvement according to FATF standards is a positive step, the downgrading with regard to Recommendation 8 could precede further changes to legislation or practices governing the sector.