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EDITOR: TERRANCE S. CARTER

"POLITICALLY EXPOSED PERSONS": SHOULD IT MATTER TO YOUR CHARITY?

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

A. INTRODUCTION

The receipt of invasive questions from their bankers by the daughters of retired Supreme Court of Canada Justice Louise Arbour has raised not only the ire of Justice Arbour, but also the public focus on some little-known amendments to Canada's money laundering and terrorist financing laws that may have far-reaching implications for charities and not-for-profit organizations (NFPs). In an October 15, 2015 interview with the Globe and Mail,[1] Justice Arbour reflected on the negative impact her former roles as a prosecutor for the international war crimes tribunals and United Nations human rights commissioner has had on her daughters' personal financial transactions and what new amendments introduced by the federal government in 2014 by way of an omnibus budget bill will have on the Canadian public. Calling it a "useless bureaucratic nightmare", the amendments to the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (the "Act")[2] introduced by Bill C-31, *An Act to implement certain provisions of the budget tabled in Parliament on February 11, 2014 and other measures*,[3] will expand the obligations of financial institutions, such as banks, insurance companies, investment dealers and real estate brokers,

* Terrance S. Carter, B.A., LL.B., Trade-Mark Agent, is the managing partner of Carters Profession Corporation, and counsel to Fasken Martineau DuMoulin LLP on charitable matters. Nancy E. Claridge, B.A., M.A, LL.B., is a partner practicing in the areas of real estate law, corporate and commercial law and wills and estates. Sean S. Carter, B.A., LL.B., practices general civil, commercial and charity related litigation from the Toronto office of Carters Professional Corporation. The authors would like to thank Tom Baker, B.A. (Hons), M.A., J.D., for assisting in the preparation of this *Alert*.

[1] Sean Fine, "Canada's senior public officials targeted by little-known corruption law", *The Globe and Mail* (15 October 2015) online: < http://www.theglobeandmail.com/news/national/canadas-senior-public-officials-targeted-by-little-known-corruption-law/article26818093/ >.

[2] SC 2000, c 17.

[3] Bill C-31, *An Act to implement certain provisions of the Budget tabled in Parliament on February 11, 2014 and other measures*, 2nd Sess, 41st Parl, 2014 [Bill C-31].

to identify "politically exposed persons" ("PEPs"), both foreign and domestic, their families and "close associates" and keep tabs on all of them, all in an effort to fight corruption, money laundering and terrorist financing.

This *Anti-Terrorism and Charity Law Alert* will review the amendments and discuss their potential impact on charities and NFPs.

B. BACKGROUND

The amendments to the Act, most of which are not yet in force,[4] are a response to the Financial Action Task Force ("FATF") recommendations, which themselves were expanded in 2012 to apply to both domestic and foreign PEPs.[5] The FATF is an international organization responsible for setting and monitoring international standards for combatting money laundering and terrorist financing. The PEP guidelines are published in International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations.[6] Amendments to the Act reflect the specific implementation of Recommendations 12 and 22, for which the FATF also published a report in 2013, FATF Guidance: Politically Exposed Persons (Recommendations 12 and 22) ("FATF Guidance"), meant to assist member countries in implementing the measures.

The FATF identifies a PEP as an individual who is or has been entrusted with a prominent function, e.g. heads of state, deputy ministers, military officers, judges, etc., indicating that many PEPs hold positions that can be abused for the purpose of laundering illicit funds or other predicate offences such as corruption or bribery. Because of the risks associated with PEPs, the FATF Recommendations require the application of additional anti-money laundering/combatting the financing of terrorism ("AML/CFT") measures to business relationships with PEPs. These requirements are preventive (not criminal) in nature, and are not to be interpreted as meaning that all PEPs are involved in criminal activity.

According to the FATF, the key to the effective implementation of Recommendation 12 is the effective implementation of customer due diligence requirements; for financial institutions to know who their

[4] http://www.parl.gc.ca/LegisInfo/BillDetails.aspx?Language=E&Mode=1&billId=6483626&View=6.
[5] FATF (2012), International Standards on Combatting Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations, online <http://www.fatf-gafi.org/topics/fatfrecommendations/documents/fatf-recommendations.html>.
[6] *Ibid.*

customers are. The annex to the recommendation commentary sets out a collection of red flags and indicators for suspicion that can be used to assist in the detection of misuse of the financial systems by PEPs during a customer relationship. Examples of such red flags are the use of corporate vehicles to obscure ownership by PEPs, information being provided by the PEP being inconsistent with other publicly available information (such as asset declarations and published official salaries), or doing business with PEPs that are connected to higher risk countries (such as those for which FATF issues public statements) or high risk industries or sectors.

Currently under the Act, financial institutions have an obligation to determine whether they are dealing with foreign PEPs, and in the event that they are, they are responsible for taking prescribed measures to monitor such individuals. Understandably, many charities operating exclusively within Canada do not generally have to be concerned with financial transactions involving "politically exposed foreign persons" ("PEFP"). However, the inclusion of "politically exposed domestic persons" ("PEDP") greatly expands the persons and transactions that will be the subject of scrutiny by financial institutions.

At present, the Act focuses on PEFPs, which includes a:

(a) head of state or head of government;
(b) member of the executive council of government or member of a legislature;
(c) deputy minister or equivalent rank;
(d) ambassador or attaché or counsellor of an ambassador;
(e) military officer with a rank of general or above;
(f) president of a state-owned company or a state-owned bank;
(g) head of a government agency;
(h) judge;
(i) leader or president of a political party represented in a legislature; or
(j) holder of any prescribed office or position,

as well as any prescribed member of such a person.

C. THE AMENDMENTS

When the amendments to the Act come into effect, the definition of a PEFP will remain the same. However, section 9.3(1) of the Act will then specify three categories of individuals, as opposed to only a PEFP. Specifically, it will also apply to "domestic PEPs " (i.e."PEDF")and "heads of international organizations". The amendments specify the following definitions for the new categories of individuals:

"**head of an international organization**" means the head of an international organization that is established by the governments of states or the head of an institution of any such organization.

"**politically exposed domestic person**" means a person who, at a given time, holds — or has held within a prescribed period before that time — one of the offices or positions referred to in any of paragraphs (a) to (j) in or on behalf of the federal government or a provincial government or the office or position referred to in paragraph (k) in a municipal government:

(a) Governor General, lieutenant governor or head of government;
(b) member of the Senate or House of Commons or member of a legislature;
(c) deputy minister or equivalent rank;
(d) ambassador, or attaché or counsellor of an ambassador;
(e) military officer with a rank of general or above
(f) president of a corporation that is wholly owned directly by Her Majesty in right of Canada or a province;
(g) head of a government agency;
(h) judge of an appellate court in a province, the Federal Court of Appeal or the Supreme Court of Canada;
(i) leader or president of a political party represented in a legislature;
(j) holder of any prescribed office or position; or
(k) mayor.

The draft regulations indicate that the prescribed period of time will be twenty years.

What is of immediate importance is the ostensibly broad application of this legislation. Not only does the legislation apply to any of the above-mentioned individuals that have held office in the last 20 years, but section 9.3(1) also specifies that it will apply to these individuals' family members and *close associates*, a designation that is not yet defined in the legislation, the draft regulations or within the FATF Guidance.

In practice, banks and other financial institutions will be responsible for determining if a client is a PEP (either foreign or domestic), or related to a PEP, and will subsequently undertake a risk assessment and monitor their account. Processes and policies will be administered based on the context of individual situations, however, when money laundering or terrorist financing is suspected, information will be turned over to the Financial Transactions and Reports Analysis Centre of Canada ("FINTRAC"). FINTRAC is a federal intelligence agency that collects, analyzes and discloses financial information and intelligence on suspected money laundering and terrorist financing, liaising with the Royal Canadian Mounted Police and Canada Revenue Agency. Under the Act, the Minister also has wide discretion to issue written directives, which can order financial institutions to take "any measure specified in the directive with respect to any

financial transaction, or any financial transaction within a class of financial transactions, originating from or bound for any foreign state or foreign entity, that occurs or is attempted in the course of their activities, or with respect to any activity that is related to any such financial transaction or class of financial transactions."[7]

D. EFFECT OF AMENDMENTS

Despite the fact that the amendments to the Act under Bill C-31 have received Royal Assent, it is unclear what its exact scope will be, as the regulations have not yet received cabinet approval, which has been made all the more complicated because of the recent change in government. In this regard, it is unclear at this point what exactly a "close associate" will mean, as the term is not defined in Bill C-31, the FATF Guidance Paper on Recommendation 12 or even in the draft regulations. It is possible that the new provision could create a very broad net of application and it may be important for anyone who has been involved with public office, directly or indirectly, to determine how it will affect them.

There are also logistical difficulties for financial institutions involved in implementing the assessment protocols and monitoring accounts. The FATF advocates persistent monitoring of financial institutions' clientele bases, but acknowledges that determining the identity of family members and close associates can be challenging.[8] For example, while there are commercial databases that are available and may assist with the identification of PEPs, these may be prohibitively expensive for some institutions, and insufficient for meeting the requirements of the law in others. In practice, FATF guidelines stress customer due diligence as the most important method financial institutions can use to identify these individuals.[9] Unlike law enforcement agencies, FATF points out that financial institutions have access to the client, and that determinations about PEP status or possible political connections can be made upon intake of clients. Specifically in Canada, however, there is very little information about risk assessment particulars. It is unclear, for instance, how financial institutions will implement policies to monitor individuals who become PEPs after becoming clients, which will be important once the legislation comes into effect. In the event that the monitoring requirements of section 9.3 are not complied with, financial institutions or

[7] Bill C-31, 268(1).
[8] FATF Guidance at 13.
[9] *Ibid*.

other entities referred to under section 5 of the Act may be subject to fines of up to $500,000 and imprisonment for terms of up to 5 years.[10]

E. CONCLUDING COMMENTS

In his article in the Globe and Mail, Sean Fine encapsulated the concerns with the amendments to the Act as follows: "The law is raising questions about how to protect against corruption in the political offices of the nation without making unwarranted or arbitrary incursions on former office-holders' privacy and the privacy of their children, spouses and associates." While Canada can remain proud of its record of compliance with international standards for money laundering and terrorist financing, both the personal and financial cost of such compliance needs to be brought to the forefront of the discussion.

The inclusion of politically exposed persons with charities is not an irregular occurrence, as their participation with organizations or in events can bring many positive attributes. However, the experience of Arbour's children is a warning bell to the dangers for organizations that do not understand and are not prepared to respond appropriately in the event the charity's relationship comes under the scrutiny of the Act.

[10] *Supra* note 1, 74(1).