Attention: Lynn Hemmings, Acting Director General
Financial Systems Division, Financial Sector Policy Branch
Department of Finance
90 Elgin Street
Ottawa, Ontario
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Sent via email: fin.fc-cf.fin@canada.ca

Regarding: 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 9th 2018, draft amendments to the Proceeds of Crime, Money Laundering and Terrorist Financing Regulations (regulations) were published in the Canada Gazette. A number of the proposed amendments are focused on "virtual currency" and "dealing in virtual currency".

Comments enclosed are made on behalf of myself (Amber D. Scott[1]), and my company Outlier Solutions Inc.[2] (Outlier), with consideration to the interactions that we have had with the bitcoin, blockchain, and cryptocurrency communities in which my team and I have participated. While community interests are taken into consideration, I do not purport to be the voice of the Canadian community, nor of the community that serves Canadians. There are many players, and their interests are diverse.

Given that the comments included here will relate primarily to "virtual currency" and "dealing in virtual currency", it seems equally relevant to disclose that I have "skin in the game." Outlier accepts payments in bitcoin, and other cryptocurrencies, and holds balances. I do the same personally. On some level, the need to make this disclosure seems a bit silly (every Canadian that comments on banking legislation is likely to have a bank account), but I want there to be no question as to my motives in this regard: I am personally and professionally invested in the success of related technologies, and in some cases, the companies that build and/or support them.

As a business owner in Canada, and in particular as the owner of a business that specializes in compliance with Canadian legislative requirements, I also have skin in the game. Here again, I benefit directly from a thriving environment that has a mix of new entrants and established players. Contrary to the "at least you'll always have

[1] https://www.outliercanada.com/about/amber-d-scott/
[2] https://www.outliercanada.com/about/

work" jokes that I often hear, however, I am not a fan of legislation for its own sake. I believe that all legislation should be outcome-based, and results oriented. To this end, I caution that we must always consider the rights of individual Canadians, including the rights to "life, liberty, and security of the person" and "the right to be secure against unreasonable search or seizure" that are part of the Canadian Charter of Rights and Freedoms. We often hear that there is a balance, but what is the balance that we are considering?

In the face of increased information collection and retention requirements relating to anti money laundering (AML), and counter terrorist financing (CTF) legislation, it is necessary to consider whether these have achieved the desired end (presumably increased prosecution of organized crime, and decreased use of the Canadian economy for large-scale criminal fund flows?). If the desired ends are not being achieved, then we should be ever more critical of the demands that we are making of citizens and businesses. This is not a theme that is limited to virtual currency, but it is one that will, no doubt, be vital to this community.

We have encouraged members of the community that may be less comfortable submitting comments to the Department of Finance directly to respond to a brief survey that remained posted throughout the summer. The comments collected via that process are attached as an appendix to this document. These comments may differ from my own opinions, and I encourage you to read them and consider them with as much gravitas.

If you have any questions or concerns in relation to the contents of this submission, please feel free to contact me.

Sincerely,

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Table of Contents

Definitions

Virtual Currency

The term virtual currency, may, in itself be confusing. It seems that the intent is to specifically capture businesses that use tokens that have, as a primary function, the concepts of "medium of exchange" and "store of value". While this has been reflected in closed-door consultation sessions, it is not well reflected in the definition as it is currently written. The policy intent can be better served by improving the definition, as well as by increasing the listed exemptions to reflect the policy intent.

The proposed definition currently reads:

> *virtual currency means*
>
> *(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). (monnaie virtuelle)*

This could be edited to read:

> *virtual currency means*
>
> *(a) a digital currency that is not a fiat currency, developed and implemented for use primarily as a mechanism of exchange and/or store of value, ~~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~~ control of a digital currency referred to in paragraph (a). (monnaie virtuelle)*

The intent of this policy is to capture cryptocurrency, or tokens that have been developed for use in a manner that mimics fiat currency, including as a mechanism for exchange, and as a store of value. This should be explicit in the description.

'Access' may be too broadly interpreted, and could capture unintended parties, such as participants (to the extent that they may perform validation or other functions, or supply software) in smart contracts or escrow services that are parties to a transaction, but do not direct or control the transaction.

Dealing In Virtual Currency

This is not formally defined in the proposed regulations. We propose the following definition:

> *Dealing in virtual currency: dealing in virtual currency means the business of conducting transactions, including the purchase and/or sale of virtual currencies, or the remittance of virtual currencies, on behalf of another person or entity, that is not conducted as a corollary of a primary business activity.*

Due to the relatively recent emergence of virtual currency related businesses, it will be important to define the policy intent. Here again, it is clear in closed-door consultation sessions that the intent is not to capture businesses that accept payment in virtual currency that would not otherwise be considered reporting entities, but without adding clarity here, there is room for interpretation (or misinterpretation).

Exclusions

The proposed definition currently reads:

> *154 (1) For greater certainty, paragraphs 7(1)(d) and (e), section 11, paragraphs 12(r) to (t), 13(k) and 14(1)(n) to (p), sections 19, 21, 26 and 28, paragraphs 30(1)(f) and (g), section 32, paragraphs 33(1)(f) and (g), section 35, paragraphs 36(g), (h) and (j), sections 40, 42, 49, 51, 55, 57, 61, 63, 67 and 69, paragraph 70(1)(d) and sections 73, 79 and 81 do not apply to*
>
> > *(a) a transfer or receipt of virtual currency as compensation for the validation of a transaction that is recorded in a distributed ledger; or*
> >
> > *(b) an exchange, transfer or receipt of a nominal amount of virtual currency for the sole purpose of validating another transaction or a transfer of information.*
>
> *(2) In this section, distributed ledger means a digital ledger that is maintained by multiple persons or entities and that can only be modified by a consensus of those persons or entities.*

This could be edited to read:

> *154 (1) For greater certainty, paragraphs 7(1)(d) and (e), section 11, paragraphs 12(r) to (t), 13(k) and 14(1)(n) to (p), sections 19, 21, 26 and 28, paragraphs 30(1)(f) and (g), section 32, paragraphs 33(1)(f) and (g), section 35, paragraphs 36(g), (h) and (j), sections 40, 42, 49, 51, 55, 57, 61, 63, 67 and 69, paragraph 70(1)(d) and sections 73, 79 and 81 do not apply to*

(a) a transfer or receipt of virtual currency as compensation for the validation of a transaction that is recorded in a distributed ledger; or

(b) an exchange, transfer or receipt of a nominal amount of virtual currency for the sole purpose of validating another transaction or a transfer of information.

(c) the holding or use of information, such as a private key in a multisignature transaction, that does not grant exclusive access to, or control over, virtual currency.

(d) receiving virtual currencies, in any amount, as payment for goods and/or services, or as a gift, by individuals or entities that are not otherwise considered to be reporting entities.

(e) providing escrow services to individuals or entities entering into a transaction where payment is rendered in virtual currency;

(f) rendering software services, including virtual currency wallet related services, where the service provider does not have exclusive access to or control of the end users' virtual currency.

(g) sending, receiving, distributing, or facilitating transactions related to digital tokens that are securities.

(h) sending, receiving, distributing, or facilitating transactions related to digital tokens that are digital representations of a good, service, or promise related to a good or service, such as loyalty points, store credit, game related credits, and platform-specific utility tokens, whether or not secondary markets have developed to facilitate the exchange of such tokens for fiat currency and/or virtual currency.

(i) operating, facilitating, or participating in peer-to-peer transactions, or networks that facilitate peer-to-peer transactions.

(2) In this section, distributed ledger means a digital ledger that is maintained by multiple persons or entities and that can only be modified by a consensus of those persons or entities.

(3) In this section private key refers to a cryptographic signature that is required to authorize a transaction.

It is my understanding that in the case of each of the proposed exclusions listed above, it is not the policy intent to capture these activities. As such, it should be made clear to Canadian businesses and the regulator, rather than left to interpretation at some vague future instance by either party.

In the case of securities tokens, there is currently an exclusion that notes that securities dealers that carry out specific functions relating to the administration of securities are not considered to be MSBs. The same logic should be applied to tokenized securities (these should be treated as securities, and not as virtual currencies).

Similarly, tokenized assets and other forms of tokenization that are not intended as stores of value and/or means of exchange outside of limited closed-loop environments (such as merchant loyalty points or game tokens) should be clearly excluded.

Identification Thresholds

There is currently a proposed identification threshold of CAD 1,000 for virtual currency exchange transactions.

This is not aligned with the identification threshold of CAD 3,000 for fiat currency exchange transactions. We propose that these two thresholds be aligned at CAD 3,000.

It does not follow that, in most instances, virtual currencies would present a greater degree of risk than fiat currencies. This is particularly perplexing when one takes into consideration that, in many cases, virtual currency transactions are logged in a public ledger system, that may be accessed by anyone, including law enforcement. In this regard, virtual currencies can be much more traceable than fiat cash.

Reporting

In reports related to virtual currency, there are a number of required fields that may not always be possible to collect, including:

- Internet Protocol address used by device
- Person's user name
- Date and time of person's online session in which request is made

These parameters are not necessarily applicable to all virtual currency transactions, including transactions completed in-person and transactions completed using automated teller machines.

Where such information is included in reporting, the fields should be made optional.

Foreign Money Services Businesses

In relation to foreign money services businesses (FMSBs), the degree to which there is an appetite and ability to enforce legislation should be considered. Currently, we hear from many MSBs within Canada that there are a multitude of unregistered MSBs operating without regard for Canadian compliance requirements, and that there has been little if any enforcement action.

At one recent conference, an MSB owner made this comment, and the FINTRAC representative present noted that they were not certain whether or not the regulator was even equipped to receive such a complaint, or whether it would fall to the RCMP to investigate.

I can, with confidence, state that I have personally observed evidence of at least a dozen such businesses in Toronto alone, and have heard of many more. These are operations with brick and mortar locations in Canada. These are operations that are competing with businesses that have borne the substantial cost of compliance. If we are not equipped to respond to flagrant disregard for Canada's regulatory regime on our own soil, is it truly reasonable to expect that we will be able to do so in instances where players do not have any physical presence in Canada?

Bank Prohibitions & Derisking

The most effective tool in this arsenal is likely to be the prohibition relating to the provision of Canadian bank accounts to MSBs that are not registered with FINTRAC. It is noteworthy, however, that within Canada MSBs that are registered with FINTRAC and able to demonstrate compliance still face tremendous hurdles in access to banking.

According to data collected in 2017 in a survey of Canadian deposit taking institutions including banks and credit unions[3], less than five percent purported to provide any type of banking facilities to MSBs. While "de facto regulator" is a role that banks are increasingly playing, it is worth considering whether this is a prudent move, or a grave mistake in terms of unintended consequences versus actual outcomes. Bodies including the Financial Action Task Force (FATF)[4], World Bank[5], and even the Department of Finance's own consultation paper released earlier this

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[3] https://www.outliercanada.com/the-secret-project-2017/

[4] http://www.fatf-gafi.org/publications/fatfrecommendations/documents/fatf-action-to-tackle-de-risking.html

[5] http://www.worldbank.org/en/topic/financialsector/brief/de-risking-in-the-financial-sector

year[6], have been critical of widespread "derisking" (referring to the practice of closing accounts for vast swaths of businesses, something that has had a dramatic impact on Canadian MSBs).

To this end, we propose a counterbalance to the prohibition on banking unregistered MSBs: a requirement to bank MSBs that are registered. Rather than forcing banks and other financial institutions to take on increased de facto regulator responsibilities, why not increase FINTRAC's responsibilities as a regulator? Currently, FINTRAC has the power to revoke the registration of MSBs that are not meeting their regulatory requirements, as well as to examine MSBs operating in Canada. This authority, rather than the authority of the banks, should be the deciding factor.

[6] https://www.fin.gc.ca/activty/consult/amlatfr-rpcfat-eng.asp