GILLMAN & GILLMAN
Barristers & Solicitors

Volume 1
No. 2
Fall, 2004

The Financial Services Regulatory Report

Cheque This Out – An Update on Canadian Payments Association's Truncation and Electronic Cheque Presentment (TECP) Project

The Canadian Payments Association's (CPA) framework for its Truncation and Electronic Cheque Presentment project is moving forward. Under the policy adopted by the Board of the CPA, financial institutions will capture and exchange three image files for each cheque. Financial institutions will be able to derive the benefits from each format for internal processing and customer service purposes.

Technical standards that will apply to the image and code line files are also being developed and are in the final stages of approval. As well, requirements for the Exchange Control System (that will manage the exchange of files between direct clearers) and for the telecom network (over which image and data files will travel) are being finalized.

The final standard for cheque specifications will be published by year-end in order to give printers and other stakeholders time to make preparations for image-based clearing. System testing is scheduled to begin in 2005.

Lessons Learned – The U.S. "Check 21" Act Experience

At the end of October, 2004, U.S. federal law (known as the "Cheque 21 Act") began allowing banks greater latitude in processing cheques electronically, reducing the time it takes for money to be deducted from a drawer's account. Canadian financial institutions should pay particular attention to the American experience in order to benefit from their lessons learned.

A recent article in *The New York Times*[1] suggests banks should pay particular attention to customer–related issues that may arise when implementing the new electronic procedures. Such issues include passing on some of the savings to customers resulting from the elimination of paper-based processing. Financial institutions should be carefully considering what fees (if any) they will charge for accessing electronic cheque images. As well, financial institutions should also consider the potential for an increase in the number of bounced cheques and the fees they are likely to derive as a result. The article also suggests that, because of the faster clearing cycle, banks adopt shorter hold periods for deposited cheques and a "no-hold" policy for deposits by customers with problem-free accounts.

Money laundering reporting and compliance officers at financial institutions should carefully consider the evidentiary implications of images of cheques on their ability to prove alteration or forgery of cheques forensically. As well, concern has been expressed that real-time or same day clearance of cheques will frustrate compliance officers who want to conduct post-deposit "due diligence" investigations and stop payments whenever their suspicions are confirmed. Preventative action may be difficult or impossible should a teller belatedly disclose his suspicions about a deposit.

[1] *The New York Times, Editorials/Letters, Sunday, October 31, 2004.*

Legislative Compliance Management – The Challenge of Keeping Up-To-Date on Legislative Developments

In conversations with a variety of bankers, many expressed a need for assistance in obtaining comprehensive, regular updates of significant, new legislation (federal and provincial) affecting banks and their financial institution affiliates.

Ensuring that banks are kept up-to-date with legislative and regulatory developments has become even more imperative following the implementation of the Office of the Superintendent of Financial Institutions (OSFI) *Guideline E-13* dealing with Legislative Compliance Management ("LCM") and the enactment of OSFI's Corporate Governance Guideline requiring banks and their directors and officers to ensure the diligent adherence to laws and regulations affecting their businesses.

Financial institutions need to manage their legal and regulatory risk appropriately. As indicated in OSFI *Guideline E-13*, "OSFI considers effective LCM to be essential to a FRFI's well-being" "since non-compliance by a FRFI or subsidiary with regulatory requirements applicable to its activities may have a critical impact on the FRFI's reputation, and/or safety and soundness."

Part of the challenge, however, facing financial institutions and their third party service providers is ensuring that they obtain timely, periodic information on relevant federal and provincial legislative and regulatory developments.

To answer this need and in light of the greater focus placed by the Superintendent of Financial Institutions on ensuring that financial institutions manage their legal and regulatory risk effectively, Gillman & Gillman will make available to subscribers, on an annual subscription basis, a monthly *Gillman Financial Services Legislative Update* (in electronic form) containing information on significant new federal and provincial legislation impacting banks (and their regulated financial services affiliates) and monitoring the status of this legislation as it proceeds through the legislative process.

In addition, subscribers will have exclusive access to the new Gillman Financial Services Legislative and Regulatory Update website containing a hyper-linked, comprehensive listing of governing statutes, regulations, guidelines, etc. relevant to banks and their regulated federally regulated financial affiliates.

Should your organization be interested in subscribing to this service and for rates and other details, please call Libby Gillman at 416.418.7204 or contact her at libbyg@lawgill.com.

Some Current OSFI Priorities

In its recent *Report on Plans and Priorities*, OSFI set forth a number of policy initiatives, both domestic and foreign, that affect the development of OSFI priorities. These include:

- ✓ The ongoing implementation and refinement of OSFI's Supervisory Framework. In the forthcoming planning period, OSFI will finish its implementation of the new ratings process for regulated institutions
- ✓ Preparation for the implementation of the Basel Capital Accord for internationally active deposit-taking institutions
- ✓ Additional policy focus on counter-terrorism and anti-money laundering efforts and ongoing co-ordination with FINTRAC. As a result of reviews which began in 2002-2003, OSFI will expand its role in assessing the quality of anti-money laundering

and counter-terrorism-financing compliance systems in federally regulated financial institutions.
    - For example, OSFI has detected some lack of self assessment and Board involvement in ensuring a comprehensive anti-money laundering compliance regime.
    - OSFI wants to ensure adequate staff training and client identification is undertaken. Particular attention will be paid to ensure group-wide "know your customer" and training standards (including those outside of Canada).
    - To respond to the need for information and the ability to respond to changing and uncertain circumstances, OSFI and FINTRAC have developed a memorandum of understanding to address the exchange of information.
    - OSFI will encourage a *daily* search through its *new* customer database for terrorist names. As well, OSFI will encourage a search through a financial institution's customer database within *one day to one week* following the posting of terrorist names.
- ✓ OSFI will place an increased emphasis on corporate governance as part of its supervisory ratings process and the release of its new corporate governance policy. OSFI plans to enhance regular communications and relationships with senior management and board members of financial institutions (for example, to assess the effectiveness of corporate governance processes in each institution).
- ✓ Current legislative initiatives include a *Bank Act* revision to bring it in line with the *Canada Business Corporations Act*.

Recent Privacy Decisions Affecting Financial Institutions

A recent Privacy Commissioner's finding of interest to financial institutions involved a telecommunications company. This decision is reported at http://www.privcom.gc.ca/cf-dc/2004/cf-dc_040531_e.asp and relates to a customer who received calls from what he believed to be a telemarketer. In fact, the caller was a representative of a market research firm that had been hired by the telecommunications company. The problem arose because the telecommunications company's client care team could not confirm that the market research firm's call was legitimate and had no information about these calls or why the complainant's personal information was being disclosed to the third party. As a result of the complaint, the client care team members were given a package of information regarding the third party research firm so that they could better respond to customer inquiries in the future. The Privacy Commissioner's office considered the matter to be resolved on this basis.

Another decision, reported at http://www.privcom.gc.ca/cf-dc/2004/cf-dc_040112_e.asp, commends a bank for the use of plain, straight-forward language in its account agreement and privacy policy and concluded that the language used complied with the PIPEDA's consent requirements. The text of the sections of the account agreement is set out in full in the reported decision and may be instructive to other financial institutions seeking to develop or revise their own agreement to ensure compliance with PIPEDA.

The Financial Services Regulatory Report is published periodically to keep you informed of developments in financial services legal and regulatory matters. This Report is a general discussion of certain legal developments and should not be relied upon as legal advice. If you require legal advice or financial regulatory consulting services, we would be pleased to discuss with you the issues raised in this Report in the context of your particular circumstances.