



FIGHTING FINANCIAL CRIME: The role of the Canadian financial sector

Keynote Address by Nicolas W. R. Burbidge
Office of the Superintendent of Financial Institutions Canada (OSFI)

To the

Money Laundering in Canada 2007:
Adding Knowledge and Building Skills Conference

The Fairmont Empress Hotel and Victoria Conference Centre
Victoria, British Columbia

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Introduction

Good Morning.

First, I would like to thank ABC Solutions for inviting me to speak at this conference, which I understand has become one of the premier Anti-Money Laundering (AML) conferences in Canada. As you probably know, OSFI has no legislated role under the Proceeds of Crime legislation. That's why it's particularly flattering to be asked to give the keynote address to this conference. One might well ask – why is OSFI involved at all, if it has no legislated role? I will get to that in a few minutes.

In thinking about domestic and international developments in the fight against money laundering (ML) and terrorist financing (TF) over the past few years, I specifically want to address why the fight against ML and TF is so important; the vital role of the financial sector; the effectiveness of our preventative measures, and last but not least, the importance to OSFI of the risk-based approach in implementing those measures.

The Big Picture – Crime Pays

When you think about it, virtually all crime has some sort of financial benefit to the perpetrator. Sure, some crimes of passion, carried out in the heat of the moment, may be exceptions, but the experts tell us that most criminal acts are done for money.

The 2007 Annual Report of the Criminal Intelligence Service Canada indicates that it has identified about 950 organized crime groups in Canada, compared to around 800 in 2006. Even when you take into account enhanced reporting, this still represents a very significant increase. The report highlights the deleterious effect organized crime has on society, including the use of firearms, the manufacture and marketing of illegal drugs, the trafficking of persons and counterfeit products, contraband, and financial crime.

The Report estimates that between \$22 billion and \$55 billion is laundered annually in Canada. In reality, it is very difficult to know with any precision how much money is laundered here, or in other countries. Everyone seems to agree, however, that the volumes of illicit funds are very large.

Role of the Financial Sector

Of course, there are many players involved in the fight against ML: law enforcement, prosecutors, policy makers and elected officials. We in the financial sector are key players as well, whether we are regulators or financial institutions. But, immersed as we often are in the minutiae of administering AML compliance and risk management measures, it is easy sometimes to lose track of why what we do is so important.

At a high level, the role of the financial sector is basically twofold.

First, the financial sector must be able to detect activity or transactions that seem suspicious and report on them to the authorities.

You might not know for sure that funds in your custody are the proceeds of crime, but you can increase the chances of identifying suspicious activity by thoroughly understanding who your clients really are, what types of transactions they would be ordinarily engaged in, and where those transactions would normally be processed. I am, of course, talking about a solid client profile. Without this base knowledge, the huge sums of money that the financial sector is spending each year on monitoring transactions would be largely ineffectual. How can you tell if something is suspicious if you don't know what normal looks like?

Second, the financial sector must ensure that good records are kept about customers. Clearly, good information is a key underpinning for meaningful intelligence reporting.

If financial institutions do spot activity that needs to be reported to FINTRAC, it is important that they are able to provide accurate and up-to-date information about the person or persons who conducted the transaction, and what made the institution suspicious. And, in the event that law enforcement needs to see documentation, accurate and complete data will help the authorities to mount a solid case for prosecution.

Cost and Effectiveness

There is no denying that the financial sector world-wide is putting a lot of effort into the fight against financial crime. In a recent KPMG International survey of

banks around the world, participants reported that their average AML costs had risen by 58% over the previous three years and would rise by an average of 34% over the next three years.

Although most participants expressed support for AML regulatory efforts, they noted that improved feedback from the authorities would enable them to focus their efforts more effectively. This is certainly a topic OSFI is asked about from time to time. Financial institutions would like more information on whether all this effort by the financial sector is paying off. Are we catching the bad guys? This is a fair question.

OSFI, of course, is not on the front lines of ML investigations and prosecutions. ML investigations are complex and painstaking; it can take months or even years to secure a conviction. In the meantime, however, the intelligence supplied by FINTRAC is proving increasingly useful in helping law enforcement to shut down criminal networks. Speaking recently to the annual conference of The Canadian Association for Security and Intelligence Studies, the Director of FINTRAC noted that the number of case disclosures that FINTRAC makes ranges between 150 and 200 cases each year. What has very dramatically increased is the size, the scope and the complexity of these cases. For example, the total value of transactions involved in FINTRAC case disclosures has doubled in each of the last three years. The size of an average case was \$3 million in 2003 and had risen to \$30 million by 2005/06. It is expected this figure will increase again for 2006/07.

OSFI's Role

The threats posed by criminal abuse of the financial system are being met with a concerted response by many countries, particularly those that are members of the Financial Action Task Force (FATF) and some members of its regional affiliates. Here in Canada, Bill C-25 -- amending the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* -- has brought into Canadian law several key AML controls that were added to the FATF standards in 2003. Most of the changes will come into effect in June of 2008. In addition, the Department of Finance has created an AML/ATF Public/Private Sector Advisory Committee to discuss matters of mutual interest in the ongoing fight against ML and TF.

So why IS OSFI involved?

OSFI considers ML and TF as significant threats to the Canadian financial system. Experience around the world has shown that weak AML controls can potentially lead to business failures and a dramatic hit to the reputation of banks, financial sectors, even whole countries.

We've long recognized that OSFI is in a unique position to help determine whether AML/ATF measures are adequate. We have a deep understanding and knowledge of our financial institutions. We know good risk controls when we see them. The fight against ML and TF is as much about good controls as it is compliance with statutory requirements. We were the first to enter into an information sharing Memorandum of Understanding with FINTRAC more than three years ago. We have made literally hundreds of recommendations to the federally regulated sector, mostly on the quality of risk management controls, but also requiring compliance with statutory provisions where required. Finally, OSFI participates in the Canadian delegation to the FATF, where we regularly share our experience and expertise with other regulators and policymakers.

The Risk-Based Approach

One very important aspect of Canada's AML regime, in both legislation and regulations, is the obligation imposed on financial institutions to apply a risk-based approach to the implementation of some AML controls. Application of the risk-based approach requires financial institutions to exercise reasonable business judgement when implementing some AML requirements, but it also enables them to allocate higher levels of limited resources to higher risks. There is, however, a baseline of requirements that applies in all situations, except for a few deemed low-risk clients and products.

As a management tool, the risk-based approach is an effective way to focus on what is most important. That is why OSFI is watchful for institutions that appear to focus overly on the "cosmetics" - managing regulatory risk - rather than the substance of a robust self-assessment program to identify potential weaknesses in AML/ATF procedures. In other words, don't focus on "keeping OSFI happy". Rather, apply critical thinking to whether your firm is adequately addressing the risk. OSFI is happiest when firms self-identify problems and can show they are addressing them. We are less pleased when we find there are issues that should have been self-identified, but have been neglected. One key indicator we are always interested in is what I would call "tone from the top". We can and have intervened at the board level to draw attention to issues directors should be vigilant about. We do not expect the board to micro-manage AML/ATF controls, but we do expect directors to be engaged, to understand their management's controls, to ensure the controls are tested regularly, and to hold management accountable to the board for needed changes.

Conclusion

For all the reasons I have mentioned, the fight against ML and TF is very important to OSFI. The financial sector plays a key role in implementing preventative measures, and you now have the flexibility of the risk-based

approach to help allocate resources effectively. Finally, I hope I have underscored why this topic is of high importance to OSFI.

In closing, I would like to thank you for your interest in attending this conference. Recent developments here in Canada and around the world indicate that AML/ATF is still top of the agenda for the financial system and regulators. During the conference, I hope you will ask lots of questions and take the opportunity to network with your counterparts in other organizations.

I wish you a great conference.