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Report of the
**Auditor General
of Canada**
to the House of Commons

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Chapter 3
Canada's Strategy to Combat Money Laundering

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The April 2003 Report of the Auditor General of Canada comprises seven chapters, a Message from the Auditor General, and Main Points. The main table of contents is found at the end of this publication.

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For copies of the Report or other Office of the Auditor General publications, contact

Office of the Auditor General of Canada
240 Sparks Street, Stop 10-1
Ottawa, Ontario
K1A 0G6

Telephone: (613) 952-0213, ext. 5000, or 1-888-761-5953
Fax: (613) 954-0696
E-mail: distribution@oag-bvg.gc.ca

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Chapter

3

Canada's Strategy to Combat Money
Laundering

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Canada's Strategy to Combat Money Laundering

Main Points

3.1 Over the past 15 years the international community has strengthened its efforts to combat drug trafficking, organized crime, and terrorism. As a key part of this strategy, countries are focussing on the money trail that links criminals to their crimes. They identify, seize, and confiscate criminal proceeds—the profits made from crimes.

3.2 Canada acted quickly to put in place legislation to deal with proceeds of crime and money laundering. However, until recently the legislation lacked two elements of what is now viewed as the international norm for an effective system to combat money laundering:

- mandatory reporting of suspicious and certain other financial transactions, and
- a financial intelligence unit to analyze these reports and to release information to intelligence and law enforcement agencies when appropriate.

3.3 Canada launched the National Initiative to Combat Money Laundering in 2000 to close these gaps. Its centrepiece was a new *Proceeds of Crime (Money Laundering) Act*. A total of \$139 million was budgeted over the first four years to establish the Financial Transactions and Reports Analysis Centre of Canada and to help the Centre's partners to perform their roles. In 2001 both the Act and the mandate of the Centre were amended to include provisions to detect and deter terrorist financing. The Centre received an additional \$34 million over three years for that role.

3.4 Canada's strategy to counter money laundering seeks to strike a balance among its various objectives. They are to strengthen law enforcement, protect personal information, and support international efforts to combat money laundering. The strategy also seeks to keep to a minimum the costs that organizations, such as banks, trust companies, and foreign-currency exchanges, incur to comply with the law to keep records, identify clients, and report unusual or suspicious transactions. With the new law, the balance has shifted to give greater weight to strengthening law enforcement, in Canada and internationally.

3.5 To meet its goals to reduce money laundering and terrorist financing, the federal government will need to deal with a series of challenges. These include the following:

- to protect the privacy rights that Canadians enjoy under the *Canadian Charter of Rights and Freedoms*,

- to develop financial intelligence that is high in quality, and that assists law enforcement and other agencies in their investigations,
- to respond to the particular challenges posed by terrorist financing, such as following the trail of small deposits and withdrawals,
- to make financial organizations and the public aware of the new rules under the legislation and to ensure that they comply with the rules,
- to establish and maintain effective working relationships across a broad range of partners and stakeholders, and
- to measure how effective the federal efforts to combat money laundering and terrorist financing are.

Background and other observations

3.6 Money laundering is a form of financial crime in which the proceeds from criminal activity are made to appear legitimate. The goal of many criminal acts is to make a profit for the individual or group that commits the crime. A strategy to fight money laundering seeks to reduce crime by making it harder for criminals to keep and use their profits.

3.7 Both the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* and the *Anti-terrorism Act* state that Parliament must review the Acts and how they are administered. To prepare for these parliamentary reviews, the Office of the Auditor General has developed a reporting process with two parts.

- This study sets the stage for a future audit of the federal government's strategy to combat money laundering. It describes money laundering and the key challenges to combatting it.
- In November 2004 we will address the issue of how well those challenges are being managed.

Introduction

3.8 Money laundering is a form of financial crime. It is the process of disguising or concealing the profits or proceeds of crime to make them appear legitimate. “Dirty money” produced through criminal activity is changed into “clean money.” The criminal origin of the clean money then becomes difficult to trace.

3.9 Money laundering has been described as a problem involving billions of dollars in Canada and many more billions worldwide. Drug trafficking is believed to be the main source of funds laundered in and through Canada, although other crimes such as fraud and smuggling are also thought to be important.

3.10 The objective of money laundering legislation is to reduce crime by making it harder for criminals to keep and use their profits. Measures are put in place to detect and deter money laundering and to make it easier to investigate and prosecute money laundering offences.

The building blocks

3.11 The building blocks of Canada’s strategy against money laundering were put in place in the late 1980s and early 1990s.

- Money laundering was made a criminal offence under the *Criminal Code* in 1989. The legislation also provided the authority to seize or restrain the proceeds of certain crimes and provided immunity to people who voluntarily reported suspicious transactions to the police.
- Beginning in 1990, the Office of the Superintendent of Financial Institutions issued guidelines and best practices for combatting money laundering. The Office also reviews compliance with these guidelines as part of its overall risk-based program of supervision of financial institutions that are federally regulated.
- The first piece of legislation, the *Proceeds of Crime (Money Laundering) Act* in 1991 required financial institutions to introduce a system to keep records and to identify clients in order to preserve financial trails for large financial transactions (over \$10,000).
- In 1991 the RCMP established three Integrated Proceeds of Crime units to investigate and prosecute major organized criminals and crime groups. Ten more were set up across Canada in 1996.
- In 1993 the RCMP and the Canadian Bankers Association signed a memorandum of understanding for voluntary reporting of all transactions that were suspicious and that might indicate money laundering.

Keeping pace with the international community

3.12 While the system that Canada put in place was broadly consistent with international standards of the time, those standards were changing. Canada was criticized for lagging behind. In 2000 the *Proceeds of Crime (Money*

Laundrying) Act was replaced by new legislation having the same name, but with a broader scope.

- The Act made it mandatory to report suspicious transactions and large cross-border movements of currency. The requirements to keep records also expanded beyond the financial sector to include accountants, real estate dealers, government agencies, and others when they acted as financial intermediaries. (Following constitutional challenges, the requirement for lawyers to report suspicious and large cash transactions, and to put in place a compliance regime, has been suspended. The courts will hear a test case to determine whether this requirement breaches solicitor-client privilege.)
- The legislation established the Financial Transactions and Reports Analysis Centre of Canada, which receives and analyzes reports provided by financial institutions and other businesses. The legislation also states that the Centre will monitor whether the businesses and financial institutions are complying with the requirement to keep records and report certain transactions.

3.13 With these changes, Canada's strategy to combat money laundering was once again consistent with those in place in other countries that are members of the Financial Action Task Force on Money Laundering. The government budgeted a total of \$139 million over four years to the Financial Transactions and Reports Analysis Centre and other federal departments and agencies to help meet their additional responsibilities. Exhibit 3.1 sets out the roles of federal departments and agencies, along with their budgets.

3.14 In 2001, the *Anti-terrorism Act* broadened the scope of the *Proceeds of Crime (Money Laundering) Act* and the mandate of the Financial Transactions and Reports Analysis Centre to allow it to detect and deter terrorist financing. The Act was renamed the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act*.

3.15 The provisions of the *Criminal Code* that deal with the application of the proceeds of crime were also expanded. From a limited list of serious crimes, they can now be applied to almost all crimes that a person can be charged with. The *Immigration and Refugee Protection Act* was also changed so that a person who is a member of an organized crime group that is laundering money can be denied entry to Canada.

Focus of the study

3.16 Both the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* and the *Anti-terrorism Act* state that Parliament must review the Acts and how they are administered by a specific date:

- the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* within five years (by 5 July 2005), and
- the *Anti-terrorism Act* within three years (by 18 December 2004).

Exhibit 3.1 National initiative to combat money laundering: Roles of federal departments and agencies and their budgets

Roles of federal departments and agencies	Budget for federal departments and agencies (\$ millions)				
	2000-01	2001-02	2002-03	2003-04	Total
Canada Customs and Revenue Agency <ul style="list-style-type: none"> • Receives declarations of import and export of large amounts of cash or money in other forms, and transmits them to the Financial Transactions and Reports Analysis Centre of Canada. • Enforces system to report when large amounts of money are taken across Canada's borders. • Investigates the evasion of taxes or duties related to money laundering or terrorist financing 	5.3	6.0	6.0	6.0	23.3
Canadian Security Intelligence Service <ul style="list-style-type: none"> • Investigates threats to national security linked to money laundering and terrorist financing. 	—	—	—	—	—
Citizenship and Immigration Canada <ul style="list-style-type: none"> • Prevents entry of, or arranges to remove non-citizens who engage in money laundering across national borders. 	0.0	0.7	0.7	0.7	2.1
Department of Finance <ul style="list-style-type: none"> • Develops and evaluates policy and regulation. • Acts as lead department in international discussions on money-laundering and terrorist-financing issues. 	0.3	0.3	0.3	0.3	1.2
Department of Justice <ul style="list-style-type: none"> • Prosecutes money-laundering offences. 	0.6	1.2	1.2	1.2	4.2
Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) ¹ <ul style="list-style-type: none"> • Receives and analyzes transaction reports. • Discloses information, if related to a money-laundering offence, to law enforcement agencies. • Makes public more aware of money laundering. • Ensures that financial organizations comply with record keeping and rules about reporting large transactions. 	18.0	25.5	26.3	21.3	91.1
Office of the Superintendent of Financial Institutions <ul style="list-style-type: none"> • Reviews policies and procedures to combat money laundering as part of its program of supervision of federally regulated financial institutions and life insurance companies. 	—	—	—	—	—
Royal Canadian Mounted Police <ul style="list-style-type: none"> • Investigates money-laundering offences related to <i>Criminal Code</i> and other federal statutes. 	2.6	4.9	4.9	4.9	17.3
Total	26.8	38.6	39.4	34.4	139.2

¹ FINTRAC also received funding to detect and deter terrorist financing in the amounts of \$10.0 million in 2001-02, \$14.7 million in 2002-03, and \$9.5 million in 2003-04.

Source: Based on information provided by the Treasury Board of Canada Secretariat.

3.17 In preparation for these parliamentary reviews, the Office has developed a reporting process involving two steps (see About the Study at the end of the chapter):

- The current study sets the stage for a future audit of the federal government's strategy to combat money laundering. It describes money laundering and the key challenges to combatting it.
- In November 2004 we will address the issue of how well the federal government is managing those challenges.

Observations

Understanding money laundering

What is money laundering?

3.18 The term “money laundering” is believed to have first been used in the United States in the 1920s to describe one method criminals used to make their profits or proceeds of crime appear legitimate. They turned to retail businesses that operated on a cash basis. The goal was to mix criminal proceeds with legal income and report the total as legitimate business earnings. It was termed money laundering because laundries were popular choices for changing dirty money into clean money.

3.19 There are a number of definitions of money laundering. Some focus on how the criminal puts the proceeds of crime into the financial system, for example, deposits directly into banks or through a business. Broader definitions equate money laundering with almost any use of criminal profits. The common thread in these definitions is the criminal's goal: to disguise the proceeds of crime to make them appear legal.

3.20 Canadian law does not define money laundering; rather the *Criminal Code* defines the offence of laundering the proceeds of crime; the Code and other federal acts define the criminal activities that produce the proceeds of crime.

- A laundering offence is any act to disguise the source of money or assets by a person who knows or believes that they were obtained from certain forms of criminal activity in Canada or abroad.
- These criminal activities include drug trafficking, bribery, fraud, forgery, murder, robbery, counterfeiting money, and manipulating stock prices.

3.21 Money laundering does not include all illegal activity. Disguising the proceeds of tax or duty evasion, for example, is not a money-laundering offence. In those cases, the government has argued that specific rules and procedures in other legislation are adequate to deal with the proceeds from offences. The *Income Tax Act*, for example, provides its own penalties for tax evasion and procedures for recovering unpaid tax.

3.22 Money laundering is a specific type of crime. The actual transactions used to launder the profits of crime are both legal and commonplace; making bank deposits, wiring funds, and exchanging currency are examples. What

makes these acts illegal is that the source of funds is from criminal activity and the reason behind the acts is to disguise their criminal origins.

3.23 For a person to be convicted of money laundering, it must be proved beyond a reasonable doubt that the funds or property were the proceeds of crime, that the accused had knowledge or belief of that fact, and that the accused intended to disguise them.

3.24 Much of the proceeds of crime are not laundered in the sense that the term is usually used. Rather, they are spent by the criminal or held in cash or bank accounts inside or outside Canada to be spent at a later date, with no attempt made to disguise their origins. A purchase of motor vehicles for personal use, for example, is thought to be one of the most common uses of the proceeds of crime.

Is there a relationship between money laundering and terrorist financing?

3.25 Money laundering involves the processing of the profits of crimes that were committed in the past so as to disguise their illegal origin. The financing of terrorism, however, involves the processing of funds—whether obtained legally or illegally—to be used in future crimes.

3.26 Following the terrorist attacks of 11 September 2001, Canada has taken a number of steps to combat terrorist financing. They are aimed at assisting the police to detect and deter the financing of terrorist activities and to investigate and prosecute offences that are related to terrorist financing.

3.27 Terrorist groups differ from large criminal organizations in several important ways.

- **Motivation.** While drug traffickers and organized crime groups seek primarily monetary gain, terrorist groups usually have non-financial goals that motivate them. According to one definition, the primary goal of terrorism is “to intimidate a population or to compel a government to do something, or abstain from doing any act.”
- **Source of funds.** The financial dealings of a terrorist organization are difficult to investigate since its funds may come from legitimate businesses that the terrorists may own and donations they have received from sympathizers. The apparently legal sources of funds may mean there are few, if any, indicators that would make one or a series of transactions stand out.
- **The size and nature of financial transactions.** Individual financial transactions tied to terrorist operations may involve amounts that are not large enough to trigger existing reporting thresholds. An FBI analysis of the events surrounding 11 September 2001, for example, indicates that the hijackers each opened accounts with a single cash or wire transfer deposit in the average amount of US \$3,000 to \$5,000. The analysis also showed that they made numerous withdrawals in small amounts using mostly debit cards.
- **Transfers of money outside the traditional financial system.** There are ways to transfer money from one person or country to another other

than using banks or financial institutions. *Hawala* and similar methods of transferring money such as the *Fei ch'ien* and *Hundi* systems have also played a role in moving terrorist funds. In the *Hawala* system, a person gives money to an agent in one country, who tells an agent in another country to give money to a specific person. The transfer is all handled through word of mouth. Funds moved this way do not leave a paper trail similar to one that would be left if the person used a traditional financial setting like a bank.

3.28 As a result, it is difficult to follow terrorist money trails. For the three-year period ending 2003-04, the government has allocated a total of \$34 million to the Financial Transactions and Reports Analysis Centre to detect and deter terrorist financing. Regulations have been developed for reporting transactions that appear to be related to terrorist financing.

What is known about the extent and impact of money laundering?

3.29 Since money laundering and the criminal activities that it attempts to conceal are hidden, it is difficult to determine how widespread money laundering is. As we noted in the Auditor General's 2002 Report, Chapter 4, *The Criminal Justice System: Significant Challenges*, estimates of the extent and effects of organized crime are based on limited information, often repeated from one report on money laundering to another.

3.30 A number of studies have reached the conclusion that there are no reliable estimates of either the extent or impact of money laundering in Canada or internationally. For example, in its most recent strategy to combat money laundering the United States Treasury states, "We still do not know the full magnitude of the money-laundering problem. The various efforts to attempt to answer this question over the years have not been satisfactory." As a result, estimates that are frequently used in Canada and internationally should be viewed with a degree of scepticism.

3.31 Nevertheless, there is a consensus that the Canadian government should pay attention to money laundering and terrorist financing. Drug trafficking—considered to be the source of much of the money laundered through Canada—is believed to be a business earning multi-billion-dollar amounts per year. Economic crimes such as fraud are also thought to be widespread in Canada.

3.32 The goal of a large number of criminal acts is to make a profit for a criminal individual or group. Money laundering enables the criminal to enjoy these profits without putting the criminal source of funds in danger of being discovered. Once laundered, the proceeds of crime can be used to finance further criminal activity, creating a cycle of crime.

3.33 The economic costs of money laundering can take many forms. For example, honest businesses cannot compete fairly with those that derive part of their income from money laundering. When money is laundered through financial institutions, the reputation, and even the integrity, of each of the institutions could be ruined.

How is money laundered?

3.34 Most of the criminal activities that require money laundering generate cash. Money laundering is usually described as a three-stage process involving placing the proceeds of crime into the financial system, creating layers of financial transactions to disguise their origins, and then moving the laundered funds back into the legitimate economy (Exhibit 3.2).

Exhibit 3.2 The money-laundering process

Money laundering is generally described as a three-stage process intended to make the profits or proceeds of crime appear legitimate.	
1. In the initial or placement stage of money laundering, the launderer introduces the criminal proceeds into the financial system.	<ul style="list-style-type: none"> This might be done by breaking up large amounts of cash into less obvious smaller sums that are then deposited directly into a bank account. The criminal might put the money into other forms such as cheques or money orders that are then collected and deposited into accounts at another location. It is at this stage that potential money laundering can be most easily detected.
2. After the funds have entered the financial system, the second— layering —stage takes place. In this phase, the launderer engages in a series of changes, or moves the funds several times to create distance from the source.	<ul style="list-style-type: none"> The funds might be used to buy and sell investments such as stocks and bonds. The launderer might wire the funds through a series of accounts at various banks around the world. In some instances, the launderer might disguise the transfers as payments for goods or services. This would give them a legitimate appearance.
3. Having successfully processed the criminal proceeds through the first two phases of the money laundering process, the launderer then moves them to the third stage— integration —in which the funds re-enter the legitimate economy.	<ul style="list-style-type: none"> The launderer might choose to invest the funds in real estate, luxury assets, or business ventures. At this third stage, it is very difficult to distinguish between legal and illegal funds.

Source: Based on information from the Financial Action Task Force on Money Laundering

3.35 The simplest forms of laundering take place close to where the original crime was committed. For example, money laundering may involve purchasing and then cashing in casino chips. In this way, the criminal profits are changed into what appears to be legal gambling profits. More complex examples can involve the purchase and sale of stocks, commodities, or property.

3.36 These techniques are best suited to relatively small and/or occasional sums. When the criminal activity is continuous, cash-based retail businesses such as car washes and laundries, video-game arcades, video rentals, and bars and restaurants have been used. Proceeds of crime are mixed with legal funds

and the total reported as legitimate business earnings. Any additional tax that may be due is treated as a cost of doing business.

3.37 When the amounts of cash to be laundered become larger, and as domestic law enforcement becomes better at identifying money laundering, the laundering process is more likely to have an international component. In addition, the three stages of money laundering tend to become more distinct.

3.38 Bulk cash has been carried or shipped out of the country, or transferred through formal or informal financial systems. Alternatively, funds have been moved through companies that engage in international trade in goods and services and thus have credible explanations for moving funds abroad.

3.39 An offshore corporation or trust may then receive the funds and place them within the international financial system. At that point, the owner of the funds may be protected by bank secrecy, corporate secrecy, and possibly solicitor-client privilege, which also provides secrecy.

3.40 There are a number of techniques that criminals have used to access these funds from home: from a debit or credit card issued by an offshore bank, through domestic accounts of a foreign bank, as profit from real estate sales or securities trading, as salary or business income from a foreign company, or as a business loan.

How is money laundering detected?

3.41 A successful money launderer tries to mimic legal transactions. As a result, it is often very difficult to differentiate illegal from legal transactions until law enforcement officers target a particular criminal act that has been committed and then unravel the money trail.

3.42 Law enforcement officers receive information from a wide range of sources when conducting criminal investigations. Traditionally, the focus has been on the original crimes, and money laundering has become visible only in the course of subsequent investigation. Analysis of RCMP investigations conducted before the new *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* was introduced, for example, indicates that most proceeds-of-crime cases originated in other law enforcement units, notably drug enforcement.

3.43 Being able to identify a client or “know your customer” is a basic part of a system to fight money laundering. At the local level, front-line employees—who deal with customers on a day-to-day basis—are believed to be in the best position to identify what might be an unusual or suspicious transaction or pattern of transactions. These employees have become the first line of defence in the federal government’s efforts to combat money laundering. They are in a position to detect the criminal or another person injecting the proceeds of crime into the financial system.

3.44 Anti-money laundering systems attempt to establish money trails by focussing first on unusual financial transactions. From the perspective of a financial institution, a transaction may appear unusual based on

- normal industry practices and knowledge of the client (for example, the client starts making frequent cash transactions in large amounts, when this has not been a normal activity for the client in the past); or
- the behaviour of the customer (for example, the client gives confusing details about the transaction).

3.45 The transaction or series of transactions moves from the unusual to the suspicious when there are reasonable grounds to suspect that the transactions are linked to a criminal offence. This is a more difficult test, and the larger financial institutions use specially trained security staff to help make the determination.

3.46 The Financial Transactions and Reports Analysis Centre of Canada has published indicators to assist in identifying suspicious transactions (Exhibit 3.3). These indicators were compiled in consultation with reporting entities, law enforcement agencies, and organizations that specialize in international financial intelligence. The indicators are based on characteristics that have been linked to money laundering or terrorist activities in the past, and they will evolve over time.

Building a strategy to combat money laundering

Canada's growing international experience

3.47 International efforts to fight money laundering have been under way for more than 15 years. They were part of the war on drugs, expanded to include the proceeds of most other serious crimes, and most recently have been included in anti-terrorism efforts.

3.48 The United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (1988) provided a framework for the international response to the problem of money laundering. Among other things, the Convention required countries to bring in legislation against the laundering of the proceeds of crime. Additional obligations were included in the 2000 United Nations Convention Against Transnational Organized Crime.

3.49 The Financial Action Task Force on Money Laundering was established following the G-7 Summit in July 1989, and Canada has been a member of the Task Force since it began. By setting and promoting international standards for anti-money-laundering systems, and identifying and listing non-cooperative countries, the Task Force seeks to limit the access of terrorists, narcotics traffickers, and other organized criminals to the international financial system.

Exhibit 3.3 Examples of common indicators of suspicious transactions

Category	Description
Cash transactions	<ul style="list-style-type: none"> • Client starts conducting frequent cash transactions in large amounts when this has not been a normal activity for the client in the past. • Client consistently makes cash transactions that are significantly below the reporting threshold amount in an apparent attempt to avoid triggering the requirements to identify and report these transactions. • Client makes cash transactions of consistently rounded-off large amounts (for example, \$8,500 or \$9,900). • Stated occupation of the client is not in keeping with the level or type of activity (for example, a student or an unemployed individual makes daily maximum cash withdrawals at multiple locations over a wide geographic area).
Economic purpose	<ul style="list-style-type: none"> • Transaction involves non-profit or charitable organization for which there appears to be no logical economic purpose, or where there appears to be no link between the stated activity of the organization and the other parties in the transaction. • Transaction appears to be out-of-the-ordinary for industry practice or does not appear to be economically viable for the client (for example, taking a mortgage or a loan at a high rate of interest).
General	<ul style="list-style-type: none"> • Client appears to have accounts with several financial institutions in one area for no apparent reason. • Client's home or business telephone number has been disconnected or there is no such number when an attempt is made to contact client shortly after opening account. • Client insists that a transaction be done quickly.
Identity documents	<ul style="list-style-type: none"> • Client wants to establish identity using something other than his or her personal identification documents. • All identification presented is foreign or cannot be checked for some reason. • All identification documents presented appear new or have recent issue dates.
Knowledge of reporting or record-keeping requirements	<ul style="list-style-type: none"> • Client attempts to convince employee not to complete any documents required to report the transaction. • Client has unusual knowledge of the law about reporting suspicious transactions.
Transactions involving accounts	<ul style="list-style-type: none"> • Account with a large number of small cash deposits and a small number of large cash withdrawals. • Client frequently uses many deposit locations outside of the home branch location. • Dormant account containing a minimal sum is reactivated. Then the account suddenly receives a deposit or series of deposits. This is followed by frequent cash withdrawals until the transferred sum has been removed. • Multiple personal and business accounts are used to collect and then funnel funds to a small number of foreign beneficiaries. This is particularly suspicious when they are in locations of concern, such as countries known or suspected to assist in money-laundering activities.
Transactions involving areas outside Canada	<ul style="list-style-type: none"> • Credit card issued by a foreign bank that does not operate in Canada is used by a client that does not live or work in the country where the card was issued. • Deposits followed within a short time by wire transfer of funds to or through certain locations. These countries are of concern because they are known or suspected to assist in money-laundering activities.

Exhibit 3.3 Examples of common indicators of suspicious transactions

Category	Description
Transactions related to offshore business activity	<ul style="list-style-type: none"> • Frequent requests for travellers' cheques, foreign currency drafts, or other negotiable instruments. • Transactions involving an offshore "shell" bank whose name may be very similar to the name of a major legitimate institution. • Unexplained electronic funds transfers by client on an in-and-out basis.

Source: Financial Transactions and Reports Analysis Centre of Canada Guideline 2: Suspicious Transactions May 9, 2002

3.50 The Task Force originally drew up 40 recommendations in 1990 to combat the misuse of the financial system by persons laundering drug money. The recommendations provide a framework to fight money laundering. They include changes to the criminal justice system and law enforcement, the financial system and its regulation, and international co-operation. For example, each country is expected to do the following:

- make money laundering a crime;
- ensure that financial institutions identify their clients and maintain client and account records, and report suspicious transactions;
- monitor the flow of money across its border; and
- co-operate with other countries to strengthen their efforts to combat money laundering.

3.51 The recommendations made by the Task Force were originally used only for the proceeds of crime involving drug trafficking. However, it was decided in 1996 to extend the recommendations to proceeds of all serious crimes. This decision was based on the experience that had been gained from investigating money laundering up to that point, and also on the fact that changes were being made in the way that money was being laundered. Money laundering techniques, for example, were becoming more sophisticated. The recommendations have now been endorsed by more than 130 countries and are widely accepted as the standards for preventing money launderers from using the financial system.

3.52 In 2002 the Task Force identified a number of areas for possible changes in its framework and invited comments from countries, international organizations, the financial sector, and other interested parties. Potential changes include modifying the way that customers are identified; changing the reporting process for suspicious transactions; identifying the actual owners of assets held by companies, trusts, and foundations; and applying the recommendations to professionals such as lawyers, accountants and financial analysts who might provide advice or other assistance in laundering criminal funds.

3.53 In April 2001 the executive boards of the International Monetary Fund and the World Bank agreed to improve the efforts made by both institutions in the global fight against money laundering. The institutions are working

with the Task Force and their member countries to incorporate the standards to combat money laundering into their surveillance and operational activities. They will also increase technical assistance, research, and education efforts in this area.

3.54 In the wake of 11 September 2001, at a special meeting on the financing of terrorism in October 2001, the Task Force expanded its mission beyond money laundering to include terrorist financing. The Task Force has issued new international standards to combat terrorist financing and called on all countries to adopt and implement them. The International Monetary Fund and the World Bank have also agreed to extend their involvement beyond anti-money-laundering to efforts aimed at preventing terrorist financing.

3.55 In June 2002 the Financial Transactions and Reports Analysis Centre of Canada was admitted as a member of the Egmont Group of financial intelligence units (FIUs). The Egmont Group was formed in 1995 to provide a forum for financial intelligence units to improve support to their respective national anti-money laundering programs. This support includes expanding and exchanging financial intelligence in a larger, more routine way, improving the expertise and capabilities of the personnel of these organizations, and fostering better communication among financial intelligence units by applying new technologies.

Canada's new strategy against money laundering

3.56 When the Financial Action Task Force evaluated Canada in 1997, it recommended that Canada implement a mandatory reporting scheme for suspicious transactions and cross-border currency movement. It also recommended that a central financial intelligence unit be established to collect, analyze, and share this information.

3.57 Canada's National Initiative to Combat Money Laundering was developed to address the shortcomings identified by the Task Force. Exhibit 3.4 sets out the current system of legislation and regulations.

3.58 The centrepiece is a new *Proceeds of Crime (Money Laundering) Act* which received royal assent on 29 June 2000. The legislation

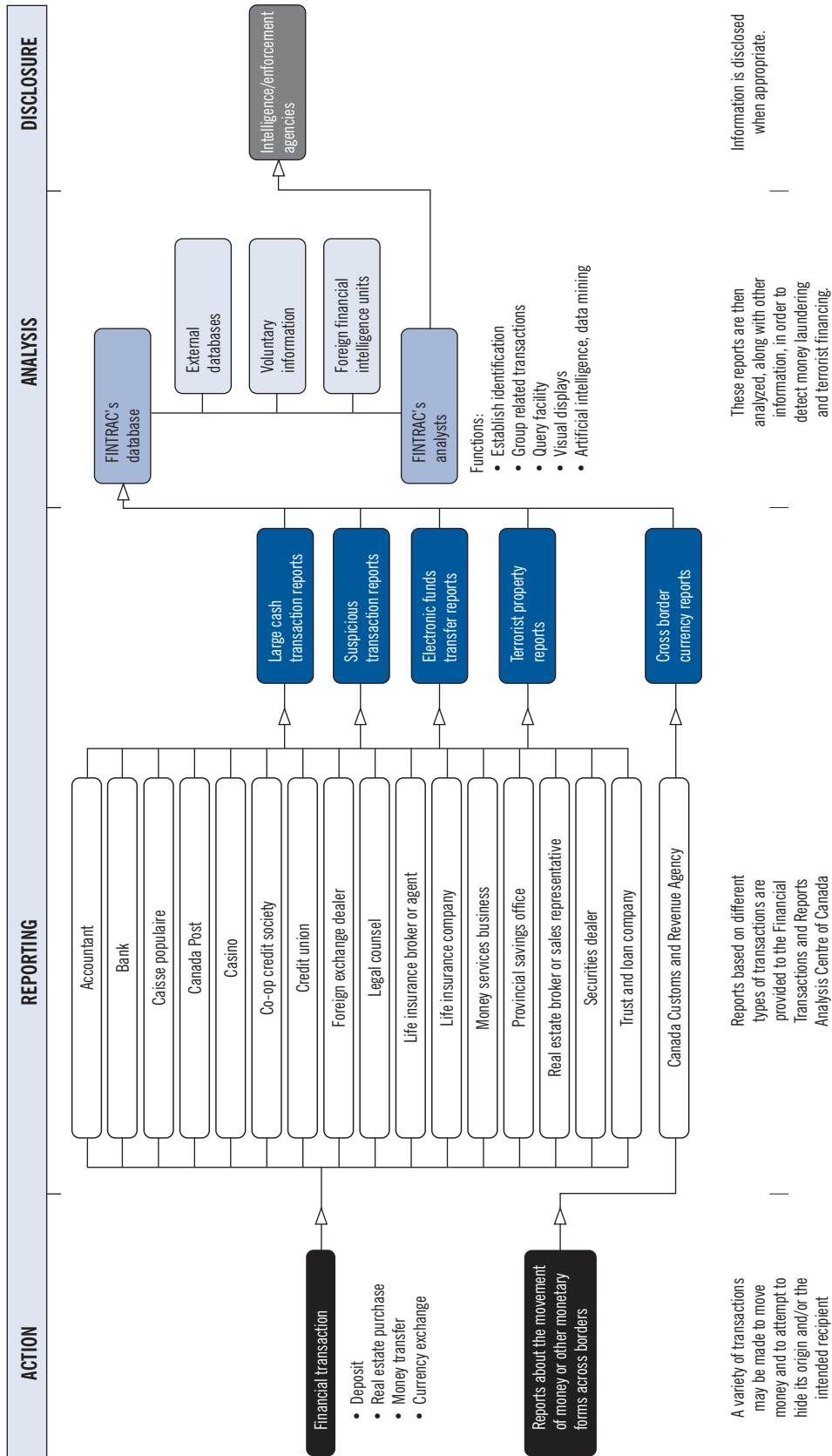
- established a system of mandatory reporting of suspicious and other types of transactions,
- required the reporting of large cross-border movements of money, and
- created the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC).

3.59 Exhibit 3.5 shows how these pieces fit together. A variety of financial transactions may be associated with money laundering or terrorist financing, including deposits, money transfers, currency exchanges, and real estate purchases.

Exhibit 3.4 Implementation of key legislation and regulations to combat money laundering, by date

Legislation and regulations	Some key provisions
Legislation	
<i>1989 Criminal Code</i>	<ul style="list-style-type: none"> • Makes laundering the proceeds of crime a criminal offence and allows law enforcement agencies to seize the proceeds of crime. • Includes offences related to terrorist activities and the financing of terrorism.
<i>2000, 2001 Proceeds of Crime (Money Laundering) and Terrorist Financing Act</i>	<ul style="list-style-type: none"> • Establishes requirements to keep records and identify clients for financial institutions and others open to being used for money laundering or the financing of terrorist activities. • Requires reporting of suspicious financial transactions and cross-border currency movements. • Creates the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) responsible for dealing with reported and other information.
<i>2001 Immigration and Refugee Protection Act</i>	<ul style="list-style-type: none"> • Stipulates that a permanent resident or a foreign national cannot be admitted if there are reasonable grounds to believe he or she has, is, or may engage in organized criminal activities, such as money laundering across national borders.
<i>2002 (proposed) Public Safety Act</i>	<ul style="list-style-type: none"> • Provides FINTRAC with the ability to collect information relevant to money laundering or terrorist financing that is stored in national security databases. • Provides FINTRAC and the Office of the Superintendent of Financial Institutions with the ability to share information on how financial institutions comply with the Act.
Regulations	
2001 Proceeds of Crime (Money Laundering) Suspicious Transaction Reporting Regulations	<ul style="list-style-type: none"> • Requires reporting where there are reasonable grounds to suspect that a financial transaction is related to a money-laundering offence.
2002 Regulations Excluding Certain Indictable Offences from the Definition of “Designated Offence”	<ul style="list-style-type: none"> • Excludes offences under the <i>Income Tax Act</i>, <i>Excise Act</i>, <i>Excise Tax Act</i>, and other Acts from the proceeds-of-crime legislation and regulations.
2002 Proceeds of Crime (Money Laundering) and Terrorist Financing Regulations	<ul style="list-style-type: none"> • Establishes requirements for reporting and keeping records of large cash transactions, confirming the identity of clients conducting transactions, and setting up a program to ensure that institutions comply.
2002 Proceeds of Crime (Money Laundering) and Terrorist Financing Suspicious Transaction Reporting Regulations	<ul style="list-style-type: none"> • Expands the scope of reporting to include suspected terrorist financing and terrorist property.
2002 Cross-border Currency and Monetary Instruments Reporting Regulations	<ul style="list-style-type: none"> • Requires persons to report to Canada Customs and Revenue Agency's customs officers the importation or exportation of large amounts of currency and monetary instruments, such as stocks, bonds, bank drafts, and travellers' cheques.

Exhibit 3.5 The business process of the Financial Transactions and Reports Analysis Centre of Canada



Source: Taken from Annual Report of the Financial Transactions and Reports Analysis Centre of Canada, 31 March 2002

3.60 Financial institutions, currency exchange dealers, casinos, and others who act as financial intermediaries are required to report the following:

- **Suspicious transactions** any financial transaction where there are reasonable grounds to suspect that it is related to a money laundering or terrorist-financing offence,
- **Large cash transactions** the receipt of cash in amounts of \$10,000 or more,
- **Electronic fund transfers** the transfer of funds of \$10,000 or more from Canada to another country or from another country to Canada,
- **Terrorist property** cash, bank accounts, insurance policies, money orders, real estate, securities and travellers' cheques, and other types of assets known to be owned or controlled by a suspected terrorist group identified by the United Nations and listed by the Solicitor General.

3.61 Anyone who fails to report these transactions is committing an offence punishable by a fine of up to \$2 million and/or imprisonment for up to ten years. It is also an offence for a person to disclose to the criminals or money launderers or anyone else that a report has been made if the intent of the person is to prejudice the criminal investigation or prosecution.

3.62 The proceeds-of-crime legislation also requires that any person who imports or exports large amounts, \$10,000 or more in cash or other liquid assets such as travellers' cheques or blank money orders across the Canadian border must report to Canada Customs and Revenue Agency. It will then forward the report to the Financial Transactions and Reports Analysis Centre. Currency can be seized if it is not declared, but will be returned after the person pays a fine, unless Canada Customs and Revenue Agency has reasonable grounds to suspect that it represents the proceeds of crime.

3.63 The Financial Transactions and Reports Analysis Centre acts as a filter. Its primary function is to receive and analyze the reports required by the legislation. Through that analysis, it determines whether there are reasonable grounds to suspect that specific information about certain transactions would be relevant to the investigation or prosecution of an offence involving money laundering or terrorist financing. If the Centre's analysis determines that the information is relevant, it is passed on to the appropriate authorities.

3.64 The Centre is also responsible for protecting the information it receives through its various sources from disclosure to anyone who is not authorized to have that information. It must also ensure that financial institutions and others comply with the requirements in the Act to report transactions, keep records, and identify clients.

Key challenges

3.65 Canada was one of the last industrialized countries to introduce a system of mandatory reporting of suspicious transactions and to establish a financial intelligence unit to receive, analyze, and pass on the information. In developing its new strategy, therefore, Canada was able to draw on both its own experience and that of other countries.

3.66 Like other countries, Canada needed to strike a balance among the objectives of enforcing the law, protecting personal information, keeping to a minimum the cost of complying with the requirements, and supporting international efforts to combat money laundering. The model that has been adopted is similar to the one in place in most other countries; differences between countries tend to reflect their particular circumstances and constitutional frameworks.

Respecting the *Canadian Charter of Rights and Freedoms* and the privacy rights of Canadians

3.67 The Centre receives personal financial information about people who are engaged in legitimate financial transactions. This raises the issue of protecting a person's reasonable expectation of privacy under the *Canadian Charter of Rights and Freedoms*.

3.68 To protect the privacy of Canadians who are completing legitimate financial transactions, several safeguards and limitations were built into the Centre's mandate. These include

- keeping the Centre itself independent and at arm's length from law enforcement agencies, such as the RCMP and other police forces;
- restricting the amount of information that can be disclosed to law enforcement agencies;
- limiting the length of time that data can be kept; and
- ensuring that there is a review by Parliament in the fifth year after the legislation's enactment.

3.69 Under the law, the Centre is also obliged to protect the personal information it stores from disclosure to an unauthorized party. To ensure that the information is protected, the Centre has put practices in place to manage information securely. This includes making sure that its facilities and equipment are secure physically and that its employees follow the security restrictions on information.

3.70 The legislation provides the Centre with authority to disclose personal financial information where there is a "reasonable suspicion." Section 8 of the Charter, the right to be secure against unreasonable search and seizure, has been interpreted by the courts to mean that a judge must authorize a request before personal financial information can be collected and given to law enforcement agencies. The judge's decision would be based on whether there were "reasonable and probable grounds" to believe that the financial transactions were being used for money laundering or terrorist financing.

3.71 In addition to protecting personal information from unauthorized disclosure, the Centre has other challenges. It must develop an operational definition of what constitutes "reasonable grounds to suspect" to guide decision-making about what information must be disclosed and why the information would be relevant to a money-laundering investigation or prosecution. Also, the Centre must develop appropriate procedures to balance the risk of not disclosing information that could prove beneficial to

investigations against the risk of making disclosures that result in unnecessary or unjustified investigations.

Developing high-quality financial intelligence for law enforcement

3.72 Law enforcement agencies use a variety of investigative techniques and intelligence sources to gather evidence against money launderers. The information that the Centre will pass on to law enforcement agencies is for two main uses:

- to trigger new investigations of offenders not previously known to law enforcement; and
- to assist with investigations into known or suspected offenders.

3.73 Once information on financial transactions is collected, it must be analyzed. How effective the analysis is will be measured in the long term by the effect it has on criminal investigations and the number of money-laundering prosecutions that law enforcement agencies are able to make. The information that the Centre provides to law enforcement agencies needs to be both useful and timely. To meet this challenge, the Centre has made three types of investments:

- **Analytical tools and methods**—selecting indicators to identify transactions related to potential money laundering and terrorist financing, and accessing government and commercial databases of interest to the Centre including the Canadian Police Information Centre's national law enforcement database
- **Recruitment and training**—choosing analysts with a variety of backgrounds, and providing them with specialized training in analysis
- **Information technology**—setting up systems and software to structure the Centre's database, manage transaction reports and match and link data for analysis

3.74 The Centre expects to receive almost 3,000,000 financial transaction reports per year. This information is analyzed to determine whether there are links and patterns among individual transaction reports that appear to be suspicious, reports about currency that is moved across borders, or other relevant data to which the agency has access.

- If links exist between these financial activities, and are found through the analysis, the identified pattern of behaviour might indicate money-laundering or terrorist-financing activity.
- Where money laundering or terrorist financing is suspected, the Centre must disclose selected information to the appropriate law enforcement agency. The selected information would include the name of the person or company who made the transaction, the name and address of the place where the transaction occurred, the time and date of the transaction, the amount and type of the transaction, the transaction number, and the account number used in the transaction.
- The Centre must keep written records of the reasons why its employees decided to disclose the data to a law enforcement agency.

- The law enforcement authorities must conduct their own investigation but can seek a court order to obtain the rest of the analysis that the Centre developed. The judge must be convinced that there are reasonable grounds to believe that an offence involving money laundering or terrorist financing has been committed and the information requested is likely to greatly assist in the investigation of the offence.

3.75 The challenge for the Centre, therefore, is to develop and enhance the ability to analyze the information in order to identify transactions that indicate money laundering or terrorist financing. The information that it discloses should also add value to the investigation of criminal offences.

Responding to the particular challenges posed by terrorist financing

3.76 We noted earlier that terrorist groups differ from large criminal organizations in several important ways: the reasons for their financing activities, the sources of their funds, the size and nature of the financial transactions they complete, and the way that they move funds outside the traditional financial system. As a result, it is difficult to follow the trails made when terrorists move money around.

3.77 The Department of Finance has developed regulations that govern how suspicious transactions related to terrorist financing should be reported. As part of the anti-terrorism initiative, the Centre was provided with additional resources to build its ability to detect and deter terrorist financing.

3.78 The Centre has begun the process of acquiring the specific tools and indicators needed to uncover the activities that show potential terrorist financing. The Centre is also building a team of analysts who will focus on terrorist financing. As with money laundering, the challenge is to develop the ability to analyze information and to disclose it in a way that will improve the investigation of offences related to terrorist financing.

Promoting awareness and compliance

3.79 The Centre has two additional mandates. The first is to increase the public's awareness and knowledge about money laundering and terrorist financing. The second is to ensure that a broad range of financial intermediaries comply with the legislation and its regulations.

3.80 The Centre has identified more than 100,000 financial and other entities that could be subject to the new reporting requirements. These range from large banks to single practitioners such as a self-employed accountant or lawyer. Only a small proportion falls within the financial sector that is regulated by the federal or provincial governments.

3.81 Based on the experience of United States officials, the Canada Customs and Revenue Agency expects to receive about 40,000 cross-border reports each year. It has incorporated the new requirements into the existing procedures.

3.82 One of the challenges for the Centre and the Canada Customs and Revenue Agency is to ensure that financial entities and the traveling public are aware of their obligations. The second is to develop an efficient and effective program to ensure that they comply.

Establishing and maintaining effective working relationships

3.83 As noted earlier, the ultimate objective of the federal government's strategy to combat money laundering and terrorist financing is to reduce crime. To succeed, co-operation, co-ordination, and information sharing are needed at several levels:

- with the financial sector, to identify suspicious and potentially criminal activity;
- within the federal government, where eight agencies have direct responsibilities related to money laundering;
- between governments, including with provincial regulators, lottery and gaming corporations, and provincial and local law enforcement agencies; and
- internationally, to deal with cross-border crime and havens for money launderers and those who finance terrorism.

3.84 As the lead agency, the Department of Finance faces the challenge of ensuring that effective working relationships among these partners and stakeholders are developed and maintained. This will allow each to do its part in meeting the strategy objectives. A timely flow of information and intelligence is particularly important.

Measuring the effectiveness of federal efforts

3.85 There are a number of challenges associated with measuring how effective a strategy to combat money laundering is.

- **The absence of benchmarks.** There are no reliable measures of the amount of money laundering that occurs. Nor is there an agreed methodology, in Canada or internationally, for determining that amount.
- **Difficulty of attributing results to a particular intelligence source.** Law enforcement agencies use a variety of investigative techniques and intelligence sources to gather evidence against money launderers. Because the information to prosecute and convict criminals comes from different sources, it may be difficult to determine the effect of the information provided by the Centre on the results of investigations.
- **The length of time required for investigations.** Investigations into proceeds of crime are usually quite complicated and involve long complex chains of evidence. It is not unusual for several years to pass between the start of an investigation and a decision on the case.

3.86 For more than a decade, members of the Financial Action Task Force on Money Laundering have been conducting self-assessments and peer reviews of their systems set up to combat money laundering. These

assessments have focussed on the need to comply with the 40 recommendations made by the Task Force in 1990 to combat money laundering.

3.87 The assessments have indicated that the member countries have followed most of the 40 recommendations. In other words, compliance has been high.

3.88 The assessments have also found, however, that only a small number of member countries have set up systems that let them know how financial transaction reports are used by law enforcement agencies. In addition, the assessments showed that members did not know whether the information from the reports resulted in money launderers being charged and convicted, or in the proceeds of crime being confiscated. The Task Force concluded that “it was not possible for the examiners to come to any firm conclusions on the issue of effectiveness.”

3.89 When the Canadian government approved funding for the National Initiative to Combat Money Laundering, it directed that the Initiative be evaluated in the third year of its operation. The evaluation would assess whether the program design and the funding provided were appropriate. The government also directed that the Initiative be formally evaluated in the fifth year to assess whether it had met its objectives. In addition, the formal evaluation will address privacy issues, whether the Initiative is cost-effective, and whether alternative approaches might produce better results.

3.90 Although the National Initiative was launched in 2000, it did not become fully operational until the supporting regulations came into force. Reporting about suspicious transactions was not mandatory until November 2001; other types of reporting began in 2002. The challenge for the Department of Finance and its partners is to ensure that a meaningful evaluation is completed before Parliament reviews the legislation.

Conclusion

3.91 At the end of 2004 we will report on how the federal government's strategy to combat money laundering has been implemented. In particular, we expect that the federal government will have responded efficiently and effectively to the challenges identified in this report:

- respecting the *Canadian Charter of Rights and Freedoms* and the privacy rights of Canadians;
- developing high-quality financial intelligence to enforce the law;
- responding to the particular challenges posed by terrorist financing;
- ensuring that banks, other financial agents, and the public are aware of their legal requirements and comply with them;
- establishing and maintaining effective working relationships across a broad range of partners and stakeholders; and

- measuring whether federal efforts are effective in reducing money laundering and terrorist financing.

3.92 Canada's strategy to combat money laundering seeks to strike a balance among the objectives of

- enforcing the law,
- protecting personal information,
- keeping down the costs of complying with the legislation, and
- supporting international efforts to fight money laundering.

3.93 With the new legislation, the balance between these objectives has shifted to give greater weight to the needs of law enforcement and to the support of international efforts.

3.94 Both the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* and the *Anti-terrorism Act* state that Parliament will review the Acts and their administration beginning in late 2004. Members of Parliament will therefore have an opportunity to determine whether the right balance is being struck.

About the Study

Objectives

Both the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* and the *Anti-terrorism Act* state that Parliament must review the Acts and how they are administered:

- The *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* within five years (by 5 July 2005); and
- The *Anti-terrorism Act* within three years (by 18 December 2004).

In preparation for these parliamentary reviews, the Office has developed a reporting process that has two steps.

- This study sets the stage for a future audit of the federal government's strategy to combat money laundering. It describes money laundering and the key challenges to combatting it.
- In November 2004 we will focus on how well those challenges are being managed.

Scope and approach

As part of the first step, we interviewed officials from Canada Customs and Revenue Agency, the Canadian Security Intelligence Service, Citizenship and Immigration Canada, the Department of Finance, the Department of Justice, the Department of the Solicitor General, the Financial Transactions and Reports Analysis Centre of Canada, the Office of the Superintendent of Financial Institutions, and the Royal Canadian Mounted Police. We also consulted international bodies involved in combatting money laundering, and we reviewed related laws and regulations, domestic and foreign reports on money laundering, and initiatives to fight money laundering.

Audit team

Assistant Auditor General: John Wiersema

Principal: Richard Smith

Richard Domingue

Rose Pelletier

Patti-Lou Fowlow

Sebastien April

For information, please contact Communications at (613) 995-3708 or 1-888-761-5953 (toll free).

Report of the Auditor General of Canada to the House of Commons—April 2003

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