



Organized Crime Research Brief no. 26

Securities and Organized Crime

BUILDING A SAFE AND RESILIENT CANADA

Evidence of traditional organized crime in securities markets is scarce, but the industry is vulnerable to fraudulent activity perpetrated by market insiders.

This report is based on a review of the academic literature, interviews with law enforcement, and securities regulators, and legislation and regulations governing Canadian securities markets. While the operation of traditional organized crime groups in securities markets was identified as having occurred in other jurisdictions, there is marginal evidence of such infiltration in Canada. Notably, there have not been any prosecutions of securities violations in Canada making use of the criminal organization provisions of the *Canadian Criminal Code*.

The complex nature of the Canadian securities sector is in large part a result of division of powers between federal and provincial levels of government. The federal government is responsible for legislation addressing criminal offences affecting the securities market in Canada, and issues relating to systemic risk and potential impact of regional and national importance. Provinces are responsible for the administration of civil and criminal justice systems, regulation of property and civil rights including the regulation and quasi-criminal offences in the securities market in their respective jurisdictions. According to the authors, this has led to a 'piecemeal' approach to current securities oversight in Canada, and could leave the sector vulnerable to organized crime.

Despite progressive movement towards greater national oversight and integration, the traditional oversight role of provinces for capital markets that function in their jurisdiction was upheld in a 2011 Supreme Court of Canada decision, where it rejected a move towards a national securities regulator. In effect, there are national integrated approaches to oversight, but these are not necessarily centrally controlled or harmonized.

The Canadian securities sector plays a key role in financial services, industry and the economy in Canada by enabling governments and business to: 1) raise equity capital and debt; 2) attract foreign investment; and 3) allow investors to trade in domestic and international capital markets. In 2010, the total market capitalization amounted to C\$2.3 trillion or 4 per cent of total trading among global capital markets. As such, even a small percentage of wealth diverted from this sector can translate into very large amounts in absolute dollar value.

The report discusses common schemes that occur in Canadian securities markets, including: fraudulent high-yield investments; pyramid and Ponzi schemes; fraudulent illicit offshore investments; and high-pressure telemarketing. The authors noted there are differences in the types of schemes prevalent within the provinces. For example, in Ontario, it is common to see boiler-room operations involving shell corporations or reverse takeovers and corporate identity hijacking, and Ponzi schemes including the use of foreign exchange trading systems. In Quebec, there seems to be greater emphasis on market manipulation, which requires access to registered investment funds, funds transfers and the artificial inflation of accounts and relevant investments. The most commonly reported groups were sophisticated organized crime groups already operating in other illicit markets, such as Outlaw Motorcycle Gangs and traditional Italian organized crime.

The authors identified a number of factors which could contribute to the vulnerability of the sector to organized criminal activities, such as: rare use of criminal procedure and sanctions against unlawful activities; information asymmetry between investors and market insiders; high cost of investigating and prosecuting securities market related offences; and failures among companies to report malfeasance in



order to maintain investor confidence.

The authors conclude that the complexity of the Canadian securities market presents certain challenges relating to the design of effective countermeasures. While all market participants have an interest in protecting themselves from risk, and the public from victimization, this must be balanced against the need to ensure economic growth and prosperity.

The report recommends raising public awareness of white-collar crimes, while securities regulators, criminal justice officials and the media should place greater emphasis on the public shaming and stigmatizing of offenders, and promote a culture of lawful and ethical behaviour. The authors also call for an 'integrated intelligence model' where control agencies would function interdependently, rather than independently within a clear set of defined goals and a coordinated strategy to detect and deter violations, thereby reducing the impact and harm by issuing proportionate sanctions.

Hicks, D., Kiedrowski, J., Gabor, T., Levi, M., and Melchers, R. (2011) *A Study of the Vulnerability of the Canadian Securities Sector to Organized Crime*. Ottawa, ON: Public Safety Canada.

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