



42.2	23.2	58.2	23.2	68.7	58.2	42.2	40.6
+1.4	-0.8	+1.9	+0.8	-0.9	+1.9	+1.4	+1.9
58.2	40.6	68.7	51.0	42.2	20.4	23.2	58.2
+1.9	-1.5	+0.9	+5.9	-1.4	15.6	+0.8	+1.9



MONEY LAUNDERING TRENDS AND TYPOLOGIES IN THE CANADIAN SECURITIES SECTOR



FINTRAC Typologies and Trends Reports – April 2013

+0.8	+1.9	-1.5	+0.9	+5.9	-1.4	+5.6	+0.8	+1.9	+1.5	-0.9	+1.9
58.2	40.6	68.7	51.0	42.2	20.4	23.2	58.2	40.6	68.7	51.0	42.2



MONEY LAUNDERING TRENDS AND TYPOLOGIES IN THE CANADIAN SECURITIES SECTOR

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FINTRAC Typologies and Trends Reports – April 2013



Introduction

Trends & Typologies reports are a series of FINTRAC publications which are intended to provide targeted feedback to specific reporting entity sectors. This particular report is focused on the securities sector in Canada and was made possible through collaboration with the British Columbia Securities Commission (BCSC), the Autorité des marchés financiers (AMF), the Investment Industries Regulatory Organization of Canada (IIROC), the Mutual Fund Dealers Association (MFDA) and representatives from securities dealers such as Raymond James, Investors Group and five of Canada's largest banks. Through this report FINTRAC seeks to address questions about money laundering that are relevant to the Canadian securities sector and have been observed in our analysis of financial transactions involving the sector. The discussions between the Canadian securities sector and FINTRAC have guided the selection of the subjects examined herein.

This report comprises three main sections. The first provides an overview of the Canadian securities sector, statistics on its reporting to FINTRAC and trends in suspicious transaction reports submitted to FINTRAC by securities dealers over the past several years. The second section discusses some of the most common money laundering methods and techniques observed in relation to the sector, and presents case examples and money laundering "red flags" based on a review of FINTRAC cases disclosed between 2007 and 2011. The third and final section of this report describes additional and emerging money laundering risks for Canadian securities dealers. A glossary of terms is provided at the end of this report for readers' convenience.

The Securities Sector in Canada

Overview

According to the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (PCMLTFA), a "securities dealer" is defined as:

"a person or entity that is authorized under provincial legislation to engage in the business of dealing in securities or any other financial instruments or to provide portfolio management or investment advising services."

Given the range of products and services offered by the Canadian securities industry, there are a number of authorized persons or entities to which the PCMLTFA applies, including:

- investment dealers;
- portfolio managers;
- brokerage firms;
- mutual fund dealers;
- venture capital firms;
- private equity firms; and
- hedge fund managers.

There is also variation among each of these authorized persons or entities, from large firms that provide a wide range of products and services to boutique firms with a small clientele and a more limited array of products and services.¹ Some securities dealers focus on providing services to individual, or "retail," investors. Others only provide services to large corporations, governments and pension funds, also known as "institutional" clients.

¹ It should be noted that despite the reference to "firms," individual securities dealers also have reporting obligations and must comply with the PCMLTFA, even if they work for a securities dealer firm. In fact, 99% of the entities included in this sector are individuals.



	+11.1	+5.9	1.8	-1.1	+0.1	+1.2			
	42.2	23.2	56.2	23.2	68	56.2	42.2	40	
	+1.4	-0.6	+1.9	+0.8	-0.9	+1.9	+1.4	+1	
	56.2	40.6	66.7	51.0	42.2	20.4	23.2	56.2	40

Securities dealers can therefore be subdivided by client base:

- **Retail firms** are focused on providing services to individual investors and can be further broken down into full service or discount brokers. **Full service brokers** provide a wide range of products and services to individual investors, while **discount brokers** generally only execute trades, either online or via telephone.
- **Institutional firms** only provide investment services to organizations such as large businesses, governments and pension funds.
- **Integrated firms** mainly consist of the investment divisions of the major Canadian banks and provide services to both retail and institutional clients.

Reporting by Canadian Securities Dealers

Securities dealers are required to establish a compliance regime and provide reports to FINTRAC. Specifically, they are required to submit large cash transaction reports (LCTRs), terrorist property reports (TPRs) and suspicious transaction reports (STRs). Other requirements for the sector include certain record-keeping obligations and the need to ascertain the identity of their clients, including determining if a client is acting on behalf of a third party and taking reasonable measures to determine if they are dealing with a politically exposed foreign person (PEFP).² The reporting requirements outlined

by the PCMLTFA are not the same as the reporting requirements of the sector's regulatory bodies;³ for example, exemptions under the latter would not necessarily result in exemptions under the former.

As noted by the Financial Action Task Force (FATF) in its 2009 report on money laundering in the securities sector, the industry plays a key role in the global economy and has certain characteristics, such as its global reach, which can make it attractive for those seeking to launder money.⁴ A strong compliance program, including consistent, high-quality reporting by all sectors covered under the PCMLTFA, is essential for FINTRAC and law enforcement to combat money laundering and terrorist financing. Deficiencies in compliance regimes are of concern to FINTRAC, and over the past few years, FINTRAC has worked with securities sector representatives to strengthen anti-money laundering (AML) compliance programs in an effort to reduce the sector's vulnerability to money laundering activities. These efforts have led to some improvements, including an increase in the number of reports filed by securities dealers, as shown in Table 1.

² A complete overview of the obligations of Canadian securities dealers under the PCMLTFA can be found on FINTRAC's website: <http://www.fintrac-canafe.gc.ca/re-ed/sec-eng.asp>

³ The regulatory environment in Canada consists of both self-regulatory organizations (SROs) and government regulators. The primary SROs in Canada are the Investment Industries Regulatory Organization of Canada (IIROC) and the Mutual Fund Dealers Association of Canada (MFDA). Currently, each province in Canada has its own securities regulator. The Canadian Securities Administrators (CSA) is an umbrella organization composed of the securities regulators in the ten provinces and three territories.

⁴ Financial Action Task Force. "Money Laundering and Terrorist Financing in the Securities Sector." October 2009.

1.5	+0.9	+5.9	-1.4	+5.6	+0.8	+1.9	+1.5	-0.1	+5.9	
2.2	23.2	56.2	23.2	68.7	56.2	42.2	40.6	68.7	56.2	
1.4	-0.8	+1.9	+0.8	-0.9	+1.9	+1.4	+1.5	-0.9	+1.9	+0.8

Table 1 – Reports Filed by Securities Dealers

	2007	2008	2009	2010	2011	Grand Total
LCTR	7	2	8	0	3	20
STR ⁵	96	160	173	254	552	1235
Grand Total	103	162	181	254	555	1255

The low number of LCTRs received by FINTRAC from securities dealers reflects the fact that physical cash is not generally used to finance securities accounts. FINTRAC has observed a substantial increase in the number of STRs filed by securities dealers since 2007.⁶ As demonstrated by Table 2, not only has the

number of STRs submitted by the sector increased since 2007, but so too has the number of unique securities dealers reporting to FINTRAC. The various categories of securities dealers that have submitted STRs to FINTRAC are outlined in Table 3.

Table 2 – Number of Securities Dealers That Have Filed Reports

	2007	2008	2009	2010	2011
Securities Dealers	19	32	29	40	55

Despite an overall improvement in STR volumes on the part of the sector, opportunities for enhancement remain. As Table 3 highlights, the vast majority (approximately 96%) of STRs received by FINTRAC to date have been submitted by various categories of investment dealers. Of these, approximately 62% are integrated firms operating under the umbrella of a larger financial institution. While variation in reporting volumes across the categories of investment

firms is expected, there may be opportunities for retail and institutional firms to improve in this regard. Of greater concern, however, is the variation in reporting volumes that exists within each category. In other words, while some retail, institutional and integrated firms provide FINTRAC with reports on a consistent basis, others do so much less frequently. Some have never submitted a report to FINTRAC at all.

Table 3 - STRs by Category of Securities Dealer

DEALER CATEGORY	% OF TOTAL
Investment Dealer	41.3%
Integrated Investment Manager/Dealer	29.7%
Investment Dealer/Discount Brokerage	24.9%
Mutual Fund Dealer	3.2%
Portfolio Manager	0.8%
Exempt Market Dealer	0.1%

⁵ These numbers include attempted suspicious transactions.

⁶ The increase in both the number of STRs submitted to FINTRAC and the number of securities dealers reporting to FINTRAC does not necessarily reflect an increase in money laundering activity in the sector. Rather, these increases can be explained by a combination of FINTRAC's increased outreach to the sector and Canadian securities dealers' increased AML vigilance.



	+11.1	+5.9	1.8	+1.1	+1.1	+1.1	+1.1	+1.1	+1.1
	42.2	23.2	56.2	23.2	68	56.2	42.2	40	40
	+1.4	-0.8	+1.9	+0.8	-0.9	+1.9	+1.4	+1.1	+1.1
	56.2	40.6	66.7	51.0	42.2	20.4	23.2	56.2	40

FINTRAC has also observed that the STRs submitted by securities dealers show a significant geographic variation in the conductors of suspicious transactions. As Table 4 highlights, most of the STRs filed by securities dealers involve transactions conducted by individuals who reside in Ontario.

The inequality in reporting volumes at a national level may be expected given the distribution of the population across the provinces. Of particular interest to FINTRAC is the fact that 13% of STRs were filed in relation to individuals with an address outside of Canada. Enhanced customer due diligence (CDD) and “know your client” (KYC) procedures are recommended in instances where a client is a foreign national and/or resides outside of the country.

The content of those reports which FINTRAC has received from the sector provides insight into suspected money laundering activity. The next section, which provides a review of the content of STRs received by FINTRAC from the securities sector, may be instructive for securities dealers seeking to improve their compliance programs. As Table 5 demonstrates, the majority (approximately 55%) of STRs filed by securities dealers relate to financial activity in the sector that is not necessarily tied to the purchase and sale of a securities product. This finding indicates that those securities dealers that are providing STRs to FINTRAC are considering “financial activity” within their sector more broadly.

Table 4 – Location of Conductor in STRs

LOCATION OF CONDUCTOR	% OF TOTAL
Ontario	35.7%
Quebec	15.5%
British Columbia	14.9%
Outside Canada	13.4%
Alberta	7.6%
Manitoba	1.1%
Saskatchewan	0.9%
Nova Scotia	0.8%
New Brunswick	0.7%
Newfoundland	0.1%
Not Completed	9.3%

1.5	+0.9	+5.9	-1.4	+5.6	+0.8	+1.9	+1.5	-0.1	+5.9
2.2	23.2	56.2	23.2	68.7	56.2	42.2	40.6	58.7	56.2
1.4	-0.8	+1.9	+0.8	-0.9	+1.9	+1.4	+1.5	-0.9	+1.9

Money laundering activity in the industry is not limited to the negotiation (i.e. purchase and sale) of securities but also includes, for example, the manner by which funds enter and exit the sector. Money laundering often involves a variety of transactions across multiple sectors; transactions involving Canadian securities dealers may represent only one part of a broader money laundering scheme. The industry must continue to be mindful that it may be but one in a series of steps in the process. Given that the overall money laundering scheme may only become apparent when reports from a number of sectors are considered together, securities dealers should consider how activity observed in their sector may connect with other financial sectors to complete the money laundering process.

In-depth analysis of the STRs submitted to FINTRAC by Canadian securities dealers confirms that attention is being paid to the multi-sector continuum of money laundering activity. Four main areas of suspicion have been flagged to FINTRAC:

1. the source and ultimate use of the funds;
2. the conductor of the transactions;
3. the complexity of the transactions; and
4. the negotiation of securities products.

The first three areas of suspicion relate primarily to instances which did not involve the purchase or sale of securities products, and are consistent with issues to which FINTRAC believes all entities with obligations under the PCMLTFA, including securities dealers, should be attentive. Table 6 provides additional details regarding these categories of suspicion.

Table 5 – STRs by Securities Products

PRODUCT	2007-2011
No Securities Product	55.1%
Shares - Canada	16.1%
MMFs/GICs	9.2%
Shares - OTC	8.0%
Mutual Funds	6.2%
Shares - Outside Canada	3.0%
Debt Instruments	1.6%
Options/Derivatives	0.8%



	+11.1	+5.9	1.8	+10.1	+1.8			
42.2	23.2	56.2	23.2	68	56.2	42.2	40	
+1.4	-0.8	+1.9	+0.8	-0.9	+1.9	+1.4	+1	
56.2	40.6	66.7	51.0	42.2	20.4	23.2	56.2	40

Table 6 – STR Suspicions⁷

SOURCE AND ULTIMATE USE OF FUNDS		COMPLEXITY OF TRANSACTIONS		CONDUCTOR		SECURITIES TRANSACTIONS	
Third Party Transactions	10.4%	Frequent Contributions/ Withdrawals	8.5%	Suspicious Individual	10.3%	Early Redemption	12.0%
Unknown Source of Funds	10.0%	Transfers Between Accounts	7.6%	Client Profile	6.4%	Deceptive/ Manipulative Trading	10.4%
Physical Certificates	7.5%			Identity Theft	6.3%	Insider Trading	3.8%
Unusual Funding	4.6%						
Total	32.5%	Total	16.1%	Total	23.0%	Total	26.2%

Where suspicions related to the source of funds deposited to securities accounts, or to the use of funds following withdrawals from securities accounts, the most common suspicions were related to third party transactions. These suspicions included incoming electronic funds transfers⁸ (EFTs) from, or outgoing EFTs to, third parties; transfers to/from securities accounts held by third parties; and negotiable instruments (e.g. certified cheques, bank drafts) made payable to third parties. Transactions of this nature are indicative of the layering stage of money laundering activity, and will be discussed in further detail later in this report.

Suspicions regarding the conductor were also flagged extensively in STRs submitted to FINTRAC by securities dealers. Suspicions often related to a current or previous criminal history, reports of actions undertaken by a securities regulator in relation to the conductor, and the client's suspicious behaviour when opening an account. Transactions that conflicted with the client profile developed by the securities dealer also raised suspicions that were ultimately reported to FINTRAC. Similarly, securities dealers reported suspicions about unnecessary complexity in their clients' transactions. Of specific concern were frequent contributions and withdrawals from securities accounts, as well as transfers between accounts.

⁷ Although an STR may report multiple suspicions, this analysis has attempted to identify the main suspicion included in each report. The main suspicions are reflected in this table.

⁸ FINTRAC receives reports related to international electronic funds transfers. The term "wire transfer" is also commonly used by securities dealers.

1.5	+0.9	+5.9	-1.4	+5.6	+0.8	+1.9	+1.5	-0.1	+5.9	
2.2	23.2	56.2	23.2	68.7	56.2	42.2	40.6	68.7	56.2	
1.4	-0.8	+1.9	+0.8	-0.9	+1.9	+1.4	+1.5	-0.9	+1.9	+0.8

When Canadian securities dealers flagged suspicions related to the purchase and sale of securities products, the most common suspicion identified was the early redemption of securities products, primarily money market funds (MMFs), GICs and mutual funds. The next most common suspicion pertained to suspected securities fraud, specifically suspected share price manipulation and wash trading.⁹ In such cases, suspicions of fraud activity prompted the securities dealer to consider how related criminal proceeds could be laundered, and resulted in a report to FINTRAC. In general, securities dealers should be mindful of the fact that criminal proceeds obtained from fraud schemes will probably need to be laundered; where fraud is suspected, attention should also be paid to possible money laundering activity.

Securities dealers may wish to consider filing STRs in certain instances where “gatekeeper reports¹⁰” are filed with provincial regulators, as this practice may assist in their consideration of suspected money laundering activity.

FINTRAC, as well as regulators and representatives of Canadian securities dealers, has for some time recognized the need for increased attention to the issue of money laundering. Based on reporting from and involving securities dealers, FINTRAC has observed suspected money laundering methods and techniques involving the Canadian securities industry. In an effort to provide further guidance to the sector, these methods and techniques, as well as case examples, are discussed in the following section.

⁹ A wash trade is an illegal stock trading practice where an investor simultaneously buys and sells shares in a company through two different brokers. This practice essentially increases the volume of trading related to the stock and signals to the market that there may be upcoming reports related to the company.

¹⁰ A gatekeeper report is one filed on entities that breach the IIROC’s Universal Market Integrity Regulations (UMIR) related to, for example, deceptive or manipulative trading.

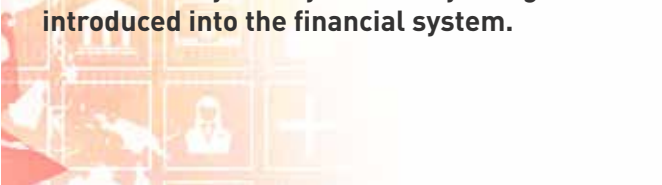
Money Laundering in the Canadian Securities Sector



Money Laundering is the process whereby “dirty money”—produced through criminal activity—is transformed into “clean money,” the criminal origin of which is difficult to trace. There are three widely recognized stages in the money laundering process:

1. **Placement** involves placing the proceeds of crime in the financial system.
2. **Layering** involves converting the proceeds of crime into another form and creating complex layers of financial transactions to disguise the audit trail and the source and ownership of funds. This stage may involve transactions such as the buying and selling of stocks, commodities or property.
3. **Integration** involves placing the laundered proceeds back in the economy to create the perception of legitimacy.

The money laundering process is continuous, with new dirty money constantly being introduced into the financial system.



Money Laundering Methods and Techniques

The money laundering methods and techniques described below were identified after FINTRAC’s analysis of STRs received from the Canadian securities sector and of FINTRAC cases which included reports both from and related to the sector. In general, the methods discussed fall into the “layering” stage of money laundering, where the goal is to create a complex series of financial transactions to disguise the source and/or ownership of the funds.

DEPOSIT OF PHYSICAL CERTIFICATES

Physical share certificates are legal documents that certify the number of shares of a corporation owned by an individual or entity. Physical bond certificates are legal documents that certify the amount of principal and interest payable to the holder. With the onset of online trading, the vast majority of certificates are now electronically registered. However, physical certificates are still used in Canada and there are legitimate reasons for an individual to possess or request them.¹¹

Notwithstanding their legitimate use, physical certificates present an increased risk of money laundering in the securities industry.¹² When they are deposited into a brokerage account, there is little information readily available to the broker confirming the source of the funds used to purchase the shares or how the client obtained them. The absence of this information presents a money laundering opportunity for criminals. The following are examples of suspected money laundering using this method, and are drawn from FINTRAC cases:

¹¹ For example, some brokerages require physical share certificates to enrol in a dividend reinvestment plan (DRIP). Physical share certificates also enable an individual to gift shares to others.

¹² The Financial Action Task Force (FATF) also discusses the use of physical certificates for money laundering in *FATF: Money Laundering and Terrorist Financing in the Securities Sector*, October 2009: 17.

1.5	+0.9	+5.9	-1.4	+5.6	+0.8	+1.9	+1.5	-0.1	+5.9	
2.2	23.2	56.2	23.2	68.7	56.2	42.2	40.6	58.7	56.2	
1.4	-0.8	+1.9	+0.8	-0.9	+1.9	+1.4	+1.5	-0.9	+1.9	+0.8

- In a stock manipulation case, after the share price was artificially increased, the perpetrators of the fraud used nominees to deposit physical certificates of that company into brokerage accounts. It is suspected that the physical certificates were given to the nominees in an off-market transaction.¹³ The shares were sold on the open market shortly after the deposits. The funds were quickly removed from the brokerage accounts and wired offshore to individuals suspected to be responsible for the stock manipulation scheme.
- In an organized crime and illegal gaming case, suspected organized crime members deposited bearer bonds into their accounts. These bonds were purchased by a suspected nominee using the proceeds of the illegal gaming operation, who then transferred the bearer bonds to the members of the criminal organization.

SECURITIES TRADED OVER THE COUNTER

Securities traded over the counter (OTC) are exchanged directly between entities rather than through an organized stock exchange such as the Toronto Stock Exchange (TSX). The OTC markets are broken into “tiers.” Companies in the highest tiers must meet stringent financial reporting standards and provide timely information to investors. Companies in the lower tiers, however, are required to provide little or no financial information; in fact, the lowest tier comprises companies that “are not willing or able to provide any financial information.”¹⁴

The Canadian securities industry’s concern with OTC securities is primarily related to securities fraud. This is due to the types of companies that are traded OTC¹⁵ as well as the less stringent reporting and registration requirements associated with these types of securities.

However, the characteristics that make OTC securities susceptible to fraud also make these products susceptible for use in money laundering schemes. For example, securities traded OTC are often “thinly traded,” meaning that there is generally little demand for, and few trades involving, such shares, which can allow criminals to transfer funds by trading OTC securities with each other. FINTRAC observed the following technique in relation to the suspected use of this money laundering method:

- A subject of an investigation purchased over one million shares in a company traded OTC in an off-market transaction for less than a third of the market price. An investment company sold the shares through an integrated firm (i.e. a major financial institution) on the part of the investigative subject. FINTRAC suspected that the terms of the sale of these shares were predetermined by the investigative subject and the purchasing party, in order to transfer the criminal proceeds. The shares were sold the next day at market price, which enabled the share purchaser to receive a 300% return on their investment in one day, and provided a seemingly legitimate explanation for the source of the criminal proceeds.

EARLY REDEMPTION OF SECURITIES

Certain investment products, such as GICs and MMFs, are designed to be held until they mature. The sale of such products prior to maturity can incur fees and/or penalties to the investor, as can the early redemption of other securities products such as mutual funds.¹⁶ However, these products can also provide criminals with a seemingly legitimate explanation for the source of their wealth, and the associated early redemption fees and penalties can be considered as the cost to

¹³ An off-market transaction is a securities transaction that is not routed through a stock exchange clearing house (e.g. TSX).

¹⁴ <http://www.otcmarkets.com/otc-101/otc-market-tiers>

¹⁵ Most companies traded OTC are speculative with no earnings history or assets. They are known to have a high failure rate.

¹⁶ Depending on the securities dealer, a mutual fund that is sold within a 30- to 90- day period will incur an early redemption fee.



	+11.1	+5.9	1.8	+1.1	+1.2	+1.2			
42.2	23.2	56.2	23.2	68	56.2	42.2	40		
+1.4	-0.6	+1.9	+0.8	-0.9	+1.9	+1.4	+1.1		
56.2	40.6	66.7	51.0	42.2	20.4	23.2	56.2	40	

obtain this appearance of legitimacy. FINTRAC observed the following techniques in relation to the suspected use of this money laundering method:

- In a drug production case, suspected members of an organized crime group deposited cash into a front money account at a casino. The individuals then withdrew the funds and were issued cheques, which were deposited into the bank accounts of the suspects and used to purchase GICs. These GICs were sold shortly afterward and the individuals did not appear to be concerned about the penalties that would result from their sale prior to maturity.
- In an international drug trafficking case, individuals in Canada received the suspected proceeds of drug sales via EFTs. These transfers were then used to purchase mutual funds, which were sold shortly thereafter without regard for the resulting penalties. The proceeds from the sale of the mutual funds were then wired offshore.

PROCEEDS OF SALE IN THE FORM OF NEGOTIABLE INSTRUMENTS

The proceeds from the sale of any securities product are commonly held in the investor's brokerage account, or are transferred to another account maintained by the investor. A money laundering method observed by FINTRAC involves the request of other negotiable instruments, such as certified cheques or bank drafts. This can provide another layer of complexity to disguise the true source and ownership of the funds. The following technique was frequently observed by FINTRAC in relation to the suspected use of this money laundering method:

- In a stock manipulation case, perpetrators used nominees to sell the acquired shares. These nominees requested that the proceeds of the sales be received in the form of certified cheques, made to the benefit of third parties.

TRANSFERS OF FUNDS BETWEEN ACCOUNTS

Transfers between accounts¹⁷ can also be a method to layer transactions and distance money from its criminal origin so that it appears legitimate. In many of the cases disclosed by FINTRAC where this method was observed, there were generally no purchases or sales of securities within the accounts. Instead, the accounts appeared to be used solely as conduits to transfer funds. For instance, following the opening of the accounts, funds were transferred in and out quickly to other brokerage or bank accounts, both domestically and internationally. The use of multiple sectors and accounts can prevent a securities dealer from readily ascertaining the source of funds, unless additional measures are taken. The following examples highlight techniques observed by FINTRAC in the application of this money laundering method:

- In a case related to the suspected misappropriation of funds, a foreign national who was a senior executive of a company transferred funds suspected of being stolen from the company to a brokerage account at a Canadian securities dealer. No securities were purchased in the account and the funds were quickly wired offshore.
- In a drug trafficking case, the suspected proceeds of crime were deposited to a number of intermediary accounts held at a variety of Canadian financial institutions prior to the transfer into a brokerage account. FINTRAC suspects that these transactions were undertaken in an effort to prevent the securities dealer from ascertaining the source of funds.

¹⁷ The transfers can be between bank accounts and brokerage accounts or between one brokerage account and another.

1.5	+0.9	+5.9	-1.4	+5.6	+0.8	+1.9	+1.5	-0.1	+5.9	
2.2	23.2	56.2	23.2	68.7	56.2	42.2	40.6	68.7	56.2	
1.4	-0.8	+1.9	+0.8	-0.9	+1.9	+1.4	+1.5	-0.9	+1.9	+0.8

- A suspected affiliate of an organized crime group involved in drug trafficking deposited several bank drafts into a securities account. The bank drafts were all under \$10,000 and were purchased from many different financial institutions. FINTRAC suspects that the bank drafts were purchased with cash in a structured manner.

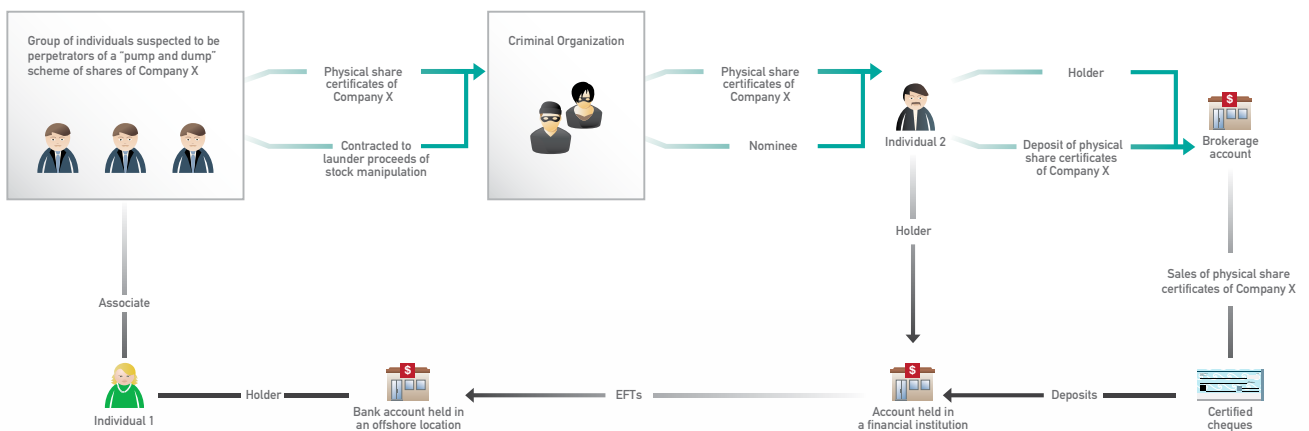
Money laundering in the securities sector is most often considered to be related to the layering stage of the money laundering model; many of the aforementioned methods and techniques highlight this fact. However, the latter example demonstrates that securities dealers are often well-positioned to identify suspected money laundering activity outside of the layering stage. While physical cash is generally not used to

finance securities accounts directly, the structured bank drafts were an indication of the “placement” stage of the money laundering process. Although this activity occurred outside of the securities sector, it is unlikely that any single financial institution would have identified this activity, and subsequently reported it to FINTRAC, because the bank drafts were purchased from many different financial institutions. It was only when considered together, at the next step in the money laundering process (in this case, the securities sector), that such activity was identified.

Sanitized Cases and Red Flags

The following examples and related red flags, drawn from FINTRAC cases, provide additional examples of observed money laundering methods and techniques in the securities sector.

Case Example 1 – Suspected Laundering of the Proceeds of Stock Manipulation



Law enforcement provided FINTRAC with information about a group of individuals who were suspected of manipulating the share price of Company X which traded OTC in the United States, commonly referred to as a “pump and dump” scheme. Individual 1 purchased shares in the company at a low price. Typical of the “pump” aspect of these types of schemes, the group

produced fraudulent reports on the company’s prospects that caused the shares to increase sharply in value. According to law enforcement, the perpetrators of the scheme had approached an organized crime group to launder the criminal proceeds that resulted from the sale of shares following the artificial price inflation.

1.5	+0.9	+5.9	-1.4	+5.6	+0.8	+1.9	+1.5	-0.1	+5.9	
22.2	23.2	56.2	23.2	68.7	56.2	42.2	40.6	68.7	56.2	
-1.4	-0.8	+1.9	+0.8	-0.9	+1.9	+1.4	+1.5	-0.9	+1.9	+0.8



According to reports from Canadian securities dealers, Individual 2 deposited physical share certificates of Company X into a brokerage account. Individual 2 was suspected of being a nominee for the organized crime group. Shortly after the deposits of the physical share certificates, Individual 2 engaged in what appeared to be a structured sale of the shares, characteristic of the “dump” phase of this type of fraud. Following the sale of the shares, Individual 2 requested early settlement¹⁸ in the form of certified cheques.

According to reports from a financial institution, the certified cheques were deposited into Individual 2’s bank account, held at a financial institution that was not affiliated with the brokerage firm. Individual 2 ordered multiple EFTs to a company located in Central America, the beneficial owner of which was Individual 1.

In this case, many of the red flags included by the securities dealer in its report to FINTRAC were related to suspicions of fraudulent activity. Specifically:

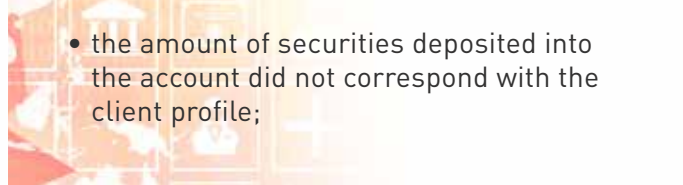
- the amount of securities deposited into the account did not correspond with the client profile;

- the individual only sold securities in the account, while making no purchases;
- the sale of shares was structured; and
- the funds were withdrawn rapidly from the brokerage account.

The “red flag” associated with suspected money laundering activity in this sector was relatively simple. Specifically:

- the settlement was requested by way of certified cheque.

Although the red flags for the securities dealer were initially related to suspected fraud, this example highlights the attention paid by the securities dealer to the possible money laundering activity which could be expected to occur in light of the suspected fraud activity. The detailed reporting from this securities dealer, coupled with reports from other sectors, allowed FINTRAC to piece together the suspected money laundering scheme and subsequently disclose the information to law enforcement.

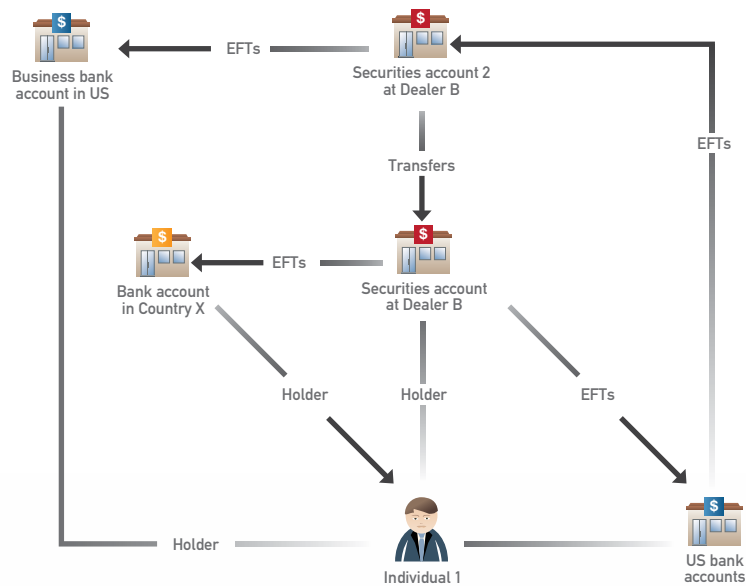


¹⁸ Generally the proceeds from the sale of shares in Canada are available “T+3,” meaning three days after the sale.



	+11.1	+5.9	1.8	+10.1	+1.8				
42.2	23.2	56.2	23.2	68	56.2	42.2	40		
+1.4	-0.8	+1.9	+0.8	-0.9	+1.9	+1.4	+1.1		
56.2	40.6	66.7	51.0	42.2	20.4	23.2	56.2	40	

Case Example 2: Suspected Laundering of the Proceeds of Corruption by a Politically Exposed Foreign Person (PEFP)



Individual 1 was the president of a state-owned bank in Country X. Information provided to FINTRAC by law enforcement indicated that Individual 1 and members of the government were suspected of tax evasion, money laundering and other illicit activities including corruption, extortion and bribery. Country X is considered by many jurisdictions as being a country of concern in relation to corruption, and at higher risk for money laundering activity. The compliance division of a major financial institution observed suspicious financial activity by Individual 1, the client of one of their new advisors. Specifically, Individual 1 did not appear to be conducting trades, but simply moving funds between accounts.

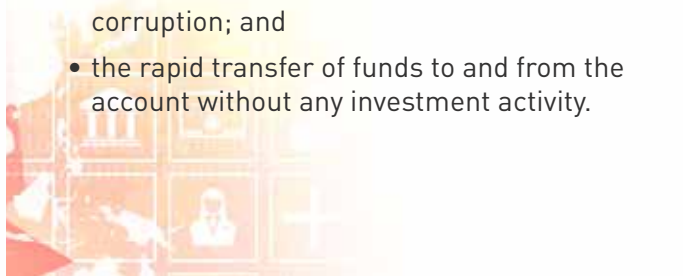
Accounts 1 and 2 at Dealer B received numerous exceptionally large-value EFTs from a business account located in the United States, as well as from a bank account located in Country X. Moreover, the securities accounts in Canada appeared to be used as conduits, or “pass-through” accounts, as part of a scheme to layer Individual 1’s criminal proceeds. Large-value incoming EFTs from the business account were often shortly followed by outgoing EFTs of similar amounts to other bank accounts located in the United States.

1.5	+0.9	+5.9	-1.4	+5.6	+0.8	+1.9	+1.5	-0.9	+5.9	
2.2	23.2	56.2	23.2	68.7	56.2	42.2	40.6	68.7	56.2	
1.4	-0.8	+1.9	+0.8	-0.9	+1.9	+1.4	+1.5	-0.9	+1.9	+0.8



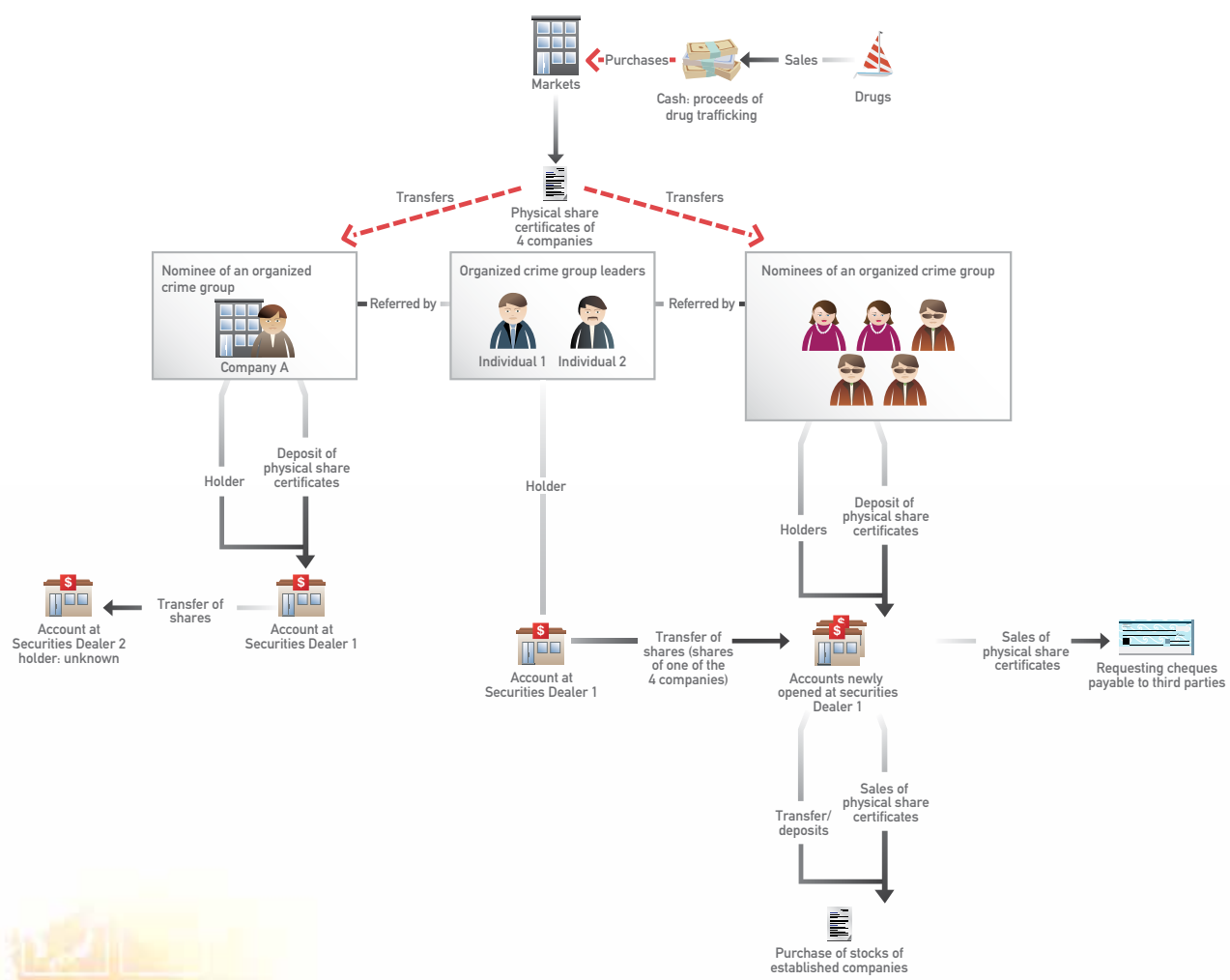
This case highlights the importance of the efforts that securities dealers must undertake to determine if their client is a politically exposed foreign person (PEFP) at account opening, and the indications that may prompt such a determination. It also demonstrates the use of multiple sectors, securities dealers and even countries to create complex layers of transactions to disguise the original source of the funds. Red flags associated with this case include:

- an account opened by a politically exposed foreign person (PEFP);
- accounts held in foreign jurisdictions which are countries of concern in relation to corruption; and
- the rapid transfer of funds to and from the account without any investment activity.





Case Example 3 – Suspected Laundering of the Proceeds of Drug Trafficking



1.5	+0.9	+5.9	-1.4	+5.6	+0.8	+1.9	+1.5	-0.1	+5.9	
2.2	23.2	56.2	23.2	68.7	56.2	42.2	40.6	68.7	56.2	
1.4	-0.8	+1.9	+0.8	-0.9	+1.9	+1.4	+1.5	-0.9	+1.9	+0.8



This case was initiated by FINTRAC after the receipt of an STR from a securities dealer which described the financial activities of seven individuals and an investment company, Company A. After the initial disclosure, FINTRAC received additional information from law enforcement which indicated that five subjects of the disclosure were suspected of acting as nominees for an organized crime group in order to launder the proceeds from drug trafficking activity.

Individual 1 and Individual 2 were the suspected leaders of the organized crime group. When the five suspected nominees and Company A opened brokerage accounts, they indicated that they were referred to the securities dealer by either Individual 1 or Individual 2. The initial deposits into the six brokerage accounts opened by the nominees were physical share certificates of four public companies traded OTC. One of the suspected nominees' brokerage accounts also received a transfer of shares from Individual 1, a suspected leader of the organized crime group. FINTRAC suspects that the funds used to purchase the physical share certificates, and the shares transferred by Individual 1, were the proceeds of drug trafficking activity. When the suspected nominees opened the brokerage accounts, they all stated that their investment plan was to sell the shares that were deposited and to use the proceeds to purchase shares in larger, more established companies.

Contrary to their stated investment plan, four of the suspected nominees quickly sold all the shares without concern that they had incurred a loss. Rather than purchase other shares, the individuals requested that the proceeds from the sale be provided to them in the form of

cheques payable to third parties. Company A requested that all the shares in its brokerage account be transferred to another account located at a different securities dealer for which the holder was unknown. This transfer ensured that the second securities dealer could not know that the source of the shares was a deposit of physical certificates.

This case consisted of a series of securities transactions involving a network of nominees to both conceal the source of the funds and integrate them into the financial system. Red flags associated with this case include:

- A number of seemingly unrelated individuals approaching a brokerage firm and indicating that they were referred by the same individual;
- The unknown origin and source of funds used to purchase the physical certificates deposited into the brokerage accounts;
- The suspected nominees selling the shares shortly after purchase, contrary to their stated investment plan; and
- The suspected nominees requesting the proceeds from the sales of securities in the form of cheques payable to third parties.

The latter case also highlights that the securities sector may be used to launder the proceeds derived from other crimes besides securities fraud. Although the majority of cases disclosed by FINTRAC between 2007 and 2011 that involved transaction reports from the securities sector were related to suspected fraud, drug trafficking activity was the next most common suspected predicate offence in these cases.



	+11.1	+5.9	1.8	+10.1	+1.2			
42.2	23.2	56.2	23.2	68	56.2	42.2	40	
+1.4	-0.6	+1.9	+0.8	-0.9	+1.9	+1.4	+1	
56.2	40.6	66.7	51.0	42.2	20.4	23.2	56.2	40

Additional Money Laundering Risks in the Securities Sector

Criminals are always seeking new means and methods to launder criminal proceeds. In recent years, some have turned to new financial vehicles that present additional money laundering risks to securities dealers. Three issues have been identified as posing particular risks for money laundering in the securities sector: the increased usage and expansion of online brokerages, publicly listed shell companies and direct electronic access to markets.

Online Brokerages

Online discount brokerages provide investors with direct access to securities markets, eliminating the need to conduct transactions through an investment advisor. In Canada, discount brokerage services are available through large financial institutions as well as through independent providers. Online discount brokerages offer challenges to the implementation of “know your client” (KYC) procedures, owing to the lack of a “brick and mortar” presence and limited face-to-face interaction with clients. The latter can make it particularly difficult to establish an investor profile, which in turn can result in increased difficulties for the brokerage in detecting suspicious financial behaviour on the part of an investor.¹⁹

The lack of face-to-face interaction also increases the risk of the use of nominees. While the use of nominees for money laundering through a casino or financial institution often requires physical participation on the part of the nominee, only an identity (real or stolen) is required to open an online brokerage account.

Publicly Listed Shell Companies

Publicly listed shell companies are companies that have few or no assets or revenues and are often failed companies that have not been de-listed. Private companies can legitimately use public shell companies to obtain capital and avoid the costly, lengthy and complex process involved in taking their company public.²⁰ However, public shell companies can also be exploited by criminals, given that they offer both a legitimate explanation for criminal proceeds and a conduit through which these proceeds can be laundered. All financial sectors, including securities dealers, should be aware of the risks of criminal exploitation posed by such companies when engaging in business with them or on their behalf. Securities dealers specifically should be aware that the deposit of shares issued by a public shell company into a securities account can be a method to launder criminal proceeds.

Securities dealers should also be alert to the aforementioned risk when involved in transactions of shares of public shell companies. Such shares are often thinly traded, meaning that there is little demand for them, making them suitable vehicles for money laundering. For example, criminals can collude with each other in transactions involving these shares, transferring money by essentially ensuring that they will be on either side of the trade, one buying and the other selling. Transactions conducted in this manner may be large, thereby eliminating the need for multiple transactions that may increase opportunities for detection, and providing criminals with a seemingly legitimate explanation for their wealth.

¹⁹ Financial Action Task Force. “Money Laundering and Terrorist Financing in the Securities Sector.” October 2009.

²⁰ This is generally referred to as a reverse merger or reverse takeover. The owners of the private company obtain control of a public company, which is then used to purchase their company.

1.5	+0.9	+5.9	-1.4	+5.6	+0.8	+1.9	+1.5	-0.1	+5.9	
22.2	23.2	56.2	23.2	68.7	56.2	42.2	40.6	58.7	56.2	
+1.4	-0.8	+1.9	+0.8	-0.9	+1.9	+1.4	+1.5	-0.9	+1.9	+0.8

Direct Electronic Access to Markets (DEA)

Direct Electronic Access (DEA) (also known as Direct Market Access) allows securities dealers to send orders directly to the marketplace of their choice. These orders can either pass through a dealer’s systems and be subject to pre-trade controls²¹ or bypass the system, thereby avoiding these controls. According to the Canadian Securities Administrators (CSA), DEA clients are generally large institutional investors who are subject to their own regulatory requirements; however, retail clients may also be able to use DEA if they have the required sophistication and resources.²² The CSA has outlined a number of market risks related to DEA, but one in particular may also present a risk for money laundering activity: sub-delegation risk.

Sub-delegation risk refers to the risk presented when a DEA client passes its identification number to another entity (sub-delegate). This activity can prevent a DEA provider from assessing the risks of their clients and may prevent them from ascertaining the identity of the individual or entity conducting the trades. For example, FINTRAC received an STR from a securities dealer regarding a sub-delegate who was allowing one of its clients to conduct manipulative trades; the sub-delegate did not provide the dealer with the trader’s name. The securities dealer filed a “gatekeeper report” with the provincial regulator, and an STR was also submitted to FINTRAC. This was important, because the increased anonymity caused by sub-delegation may allow individuals to conduct securities transactions to layer funds through the industry. Anonymity of individuals using DEA also increases the risk that they can be on both sides of a securities transaction and, in essence, conduct wash trades for money laundering purposes.

Conclusion

The money laundering methods discussed in this report will be used by criminals as long as they continue to be successful. Canadian securities dealers are attentive to the types of fraud that can occur in the sector; where securities fraud is suspected, consideration should be given to the money laundering activity that can be expected to follow. Moreover, as this report has highlighted, securities fraud is not the only predicate offence to generate criminal proceeds that are laundered through the sector. FINTRAC recommends that Canadian securities dealers continue to enhance their efforts to identify and report suspected money laundering activity in the sector, as well as remain attentive to the money laundering activity which may be expected to take place in cases where fraud is suspected. It is hoped that increased attention will lead to further improvements in both the quantity and quality of reporting.

As this report has illustrated, the majority of money laundering methods and techniques involving the securities sector appear to be related to the layering stage of the money laundering model. Complex layers of transactions need not be undertaken in one sector alone. In fact, as this report has demonstrated, securities dealers appear to be one stage in a continuum of money laundering activities involving multiple sectors. As exhibited by the reports received by FINTRAC from the sector to date, many securities dealers in Canada do consider “financial activity” in their sector more broadly, and consider the potential for money laundering activity when suspected fraudulent activity in the sector has been identified. FINTRAC recommends that securities dealers continue to be vigilant in considering how activities in their sector may “fit” the broader money laundering cycle.

²¹ These may include compliance and regulatory controls, including AML.

²² Proposed National Instrument 23-103, *Electronic Trading and Direct Electronic Access to Marketplaces*.



	+11.1	+5.9	-1.8	+10.1	+1.8				
	42.2	23.2	56.2	23.2	66.7	56.2	42.2	40	
	+1.4	-0.8	+1.9	+0.8	-0.9	+1.9	+1.4	+1	
	56.2	40.6	66.7	51.0	42.2	20.4	23.2	56.2	40

All financial sectors in Canada are vulnerable to the efforts of those seeking to launder their criminal proceeds, and securities dealers are no exception. A strong compliance program is essential in order to reduce this vulnerability. FINTRAC and Canadian securities dealers have separate yet complementary responsibilities in this regard; any deficiencies in compliance programs are of mutual concern, and must be addressed. This report, produced in collaboration with securities regulators and representatives from securities dealers, is one of a number of initiatives to strengthen the sector's compliance activities. As criminals' money laundering methods become more sophisticated and investment products become more complex, the securities sector will face additional challenges in detecting and deterring money laundering. FINTRAC values the efforts that the securities sector has made in the fight against money laundering and looks forward to continued collaboration with the sector to detect, deter and disrupt money laundering.

1.5	+0.9	+5.9	-1.4	+5.6	+0.8	+1.9	+1.5	-0.1	+5.9
22.2	23.2	56.2	23.2	68.7	56.2	42.2	40.6	68.7	56.2
-1.4	-0.8	+1.9	+0.8	-0.9	+1.9	+1.4	+1.5	-0.9	+1.9

Annex

Glossary of Securities Terms

BROKERAGE ACCOUNT:

An account that allows an investor to buy, sell, and hold securities. Depending on the type of brokerage account, an investor can either conduct the trades himself or have the trades conducted by an investment advisor.

BROKERAGE FIRM:

A firm that conducts transactions on behalf of a client. Some brokerage firms only conduct transactions, while others also offer different types of investment advisory services.

INVESTMENT DEALER:

Securities firms that employ investment advisors to work with retail and institutional clients. Investment dealers have underwriting, trading and research departments.

HEDGE FUND:

An actively managed portfolio of investments that uses advanced investment strategies such as leveraged, long, short and derivative positions with the goal of generating high returns. Hedge funds do not have the same regulatory requirements as other investment managers and are generally only open to accredited investors, including institutions, pension plans and high net-worth individuals.

HEDGE FUND MANAGER:

The individual or firm who oversees and makes decisions about the investments held in a hedge fund.

GATEKEEPER REPORT:

Under IIROC's Universal Market Integrity Regulations (UMIR), securities dealers are required to file reports on entities that conduct themselves in a way that breaches the UMIR Marketplace Rules, such as those that prevent deceptive or manipulative trading.

PHYSICAL CERTIFICATES:

Documents signed on behalf of a corporation that serve as legal proof of ownership of the number of shares indicated. They are registered in the owner's name.

PORTFOLIO MANAGER:

The person or persons responsible for investing a mutual, exchange-traded or closed-end fund's assets, implementing its investment strategy and managing the day-to-day portfolio trading.

PRIVATE EQUITY FIRM:

An investment firm that pools capital and invests in companies that are not listed on a public stock market.

PUMP-AND-DUMP:

A scheme that attempts to boost the price of a stock through recommendations based on false, misleading or greatly exaggerated statements.

SHELL COMPANY:

A company that has few or no assets or revenues. A shell company can either be private or publicly traded.

TRANSFER AGENT:

A company assigned by a corporation to maintain records of investors and account balances and transactions, to cancel and issue certificates, to process investor mailings and to deal with any associated problems (i.e. lost or stolen certificates).

VENTURE CAPITAL FIRM:

An investment company that uses its investors' capital to invest in start-ups and other risky but potentially profitable ventures.

WASH TRADING:

An illegal stock trading practice where an investor simultaneously buys and sells shares in a company through two different brokers, in essence increasing the volume and signalling to the market that there may be upcoming news about the company.