A Primer for In-House Counsel

Corporate and Financial Crimes

Part 4 of 6

MONEY LAUNDERING

Blakes

Introduction

In this six-part series on corporate and financial crimes, the Blakes Business Crimes, Investigations & Compliance group outlines basic principles of criminal and quasi-criminal law that may arise in the running of a business. Armed with insights from years of multidisciplinary knowledge and experience, our lawyers provide brief answers to questions that in-house counsel routinely ask relating to these issues.

If you would like more information or to discuss a specific issue, please contact any member of our Business Crimes, Investigations & Compliance group.

SERIES ON CORPORATE AND FINANCIAL CRIMES

1. Criminal Law 101

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Preface

Money laundering and financing of terrorist activities has become a high priority for law and policy makers, regulators and law enforcement worldwide. The events of 9/11 are partly responsible for this heightened attention, but over the last decade there has also been a general recognition of the central role money laundering plays in profit-motivated crimes which include large-scale organized crime, drug trafficking, corruption, fraud and terrorism. With the threat of money laundering and terrorist financing increasing as a result of technological advances in e-commerce and the global diversification of financial markets, anti-money laundering and anti-terrorist financing laws and policies choke off terrorists and other criminals from their money supply, impeding their activities.

Over the last decade, money laundering has played a central role in profit motivated crimes, including corruption, fraud and terrorism.

What is Money Laundering and Terrorist Financing?

MONEY-LAUNDERING OFFENCE

Money laundering occurs after a person has accumulated money from the commission of a criminal act. To avoid drawing attention to their crime, a launderer disguises the existence, nature, source, ownership, location and disposition of their proceeds. Typically, proceeds from crime are in cash form, and in order for the launderer to make use of that cash in the broader economy, for example, to pay a Visa bill, the cash must be disguised as legitimate earnings. The process of transforming dirty money (that is produced through criminal activity) into legitimate "clean" currency (whose origin is difficult to trace) is called "money laundering."

While the techniques and methods used to disguise the source of money or assets derived from criminal activity vary considerably, the process unfolds in three distinct stages:

1. **Placement:** This stage involves placing the proceeds of crime in the financial system. Money launderers pay particular attention to the requirements of anti-money laundering legislation in order to avoid scrutiny of their activities and so that the illegal funds may be placed into the financial system unnoticed. Structuring, making multiple small deposits to break up large amounts of currency or conducting many small transactions at non-reportable levels are common placement techniques. This avoids triggering reporting or identification requirements.

2. **Layering:** This stage involves converting proceeds of crime into complicated layers of financial transactions to distance the funds from the original source and obscure the audit trail. Layering procedures may involve disguising ownership of funds to camouflage the illegal source or transferring funds to offshore accounts.

3. **Integration:** At this final stage, the laundered proceeds are reintroduced back into the economy to cultivate the perception of legitimacy. These funds are legitimized using various means such as purchasing investments and other commodities.

Various acts committed with the intention to conceal or convert property or the proceeds of property (such as money) knowing or believing that these were derived from the commission of certain designated offences is considered a money-laundering offence under Canadian law. In this context, a designated offence includes, but is not limited to, those relating to illegal drug trafficking, bribery, fraud, forgery, murder, robbery, counterfeit money, stock manipulation, tax evasion and copyright infringement. A money-laundering offence may also extend to property derived from illegal activities that took place outside Canada.

TERRORIST-FINANCING OFFENCE

Terrorist financing occurs when a person provides funds for terrorist activity. The funds involved in terrorist-financing offences may be raised from legitimate sources, such as personal donations and profits from businesses, or from criminal sources, such as the drug trade, the smuggling of weapons and other goods, fraud, kidnapping and extortion.

Terrorists use similar techniques to money launderers in order to evade authorities' attention and to protect the identity of their sponsors and of the ultimate beneficiaries of the funds. However, financial transactions associated with terrorist financing tend to be in smaller amounts than with money laundering. The detection and tracking of terrorist financing funds become much more difficult when terrorists raise funds from legitimate sources. Terrorists use various methods to move their funds including the banking system, informal value-transfer systems, Hawalas and Hundis, and the physical transportation of cash, gold and other valuables through smuggling routes.

Under Canadian law, terrorist-activity financing offences make it a crime to knowingly collect or provide property, including money, either directly or indirectly, to carry out terrorism-related crimes. This includes inviting someone else to provide property for this purpose. It also includes the use or possession of property to facilitate or carry out terrorist activities.

It is a crime to knowingly collect or provide property, including money, directly or inderctly, to carry out terrorism related crimes.

How has Canada Responded to Money Laundering and Terrorist Financing?

Most developed countries have introduced laws to deal with money laundering and terrorist financing. Canada has implemented the Proceeds of Crime (Money Laundering) and Terrorist Financing Act (the "Anti-Money Laundering Legislation") to deal specifically with this problem as it relates to certain Regulated Entities (as defined below), each of which are prone to abuse by organized criminals and terrorists. The Regulated Entities covered under the Anti-Money Laundering Legislation include:

- financial entities (such as banks and credit unions);
- life insurance companies, brokers and agents;
- securities dealers, portfolio managers and investment counsellors;
- money services businesses and foreign exchange dealers;
- accountants and accounting firms;
- real estate brokers or sales representatives;
- casinos;
- dealers in precious metals and stones;
- public notaries and notary corporations of British Columbia; and
- real estate developers (collectively, the "Regulated Entities").

Each of these entities is susceptible to being used for money laundering and the financing of terrorist activities because their operations are conducive to conversion or concealment of funds. Regulated Entities are subject to specific regulatory requirements imposed by Anti-Money Laundering Legislation, which involve, among other things, record-keeping, client identification, risk rating, ongoing monitoring for suspicious transactions and reporting of suspicious and certain other threshold transactions. Regulated Entities can be subject to serious administrative monetary penalties and criminal sanctions if regulatory requirements are not met.

A discussion of the risks and regulatory requirements of Regulated Entities is beyond the scope of this primer, but it is important to understand that even companies that are not regulated under the Anti-Money Laundering Legislation are subject to the general anti-money laundering provisions of the *Criminal Code*.

This primer discusses the risks posed by the *Criminal Code* for all companies and cites some general best practices aimed at minimizing this risk.

The risk posed by the *Criminal Code* is not just legal in nature – there is a reputational component as well. **Even if eventually found innocent of wrongdoing, a company publicly accused of participating, aiding or abetting a money laundering scheme can suffer severe negative publicity that can lead to a long-term negative perception in the marketplace.** By learning about the anti-money laundering offences under the *Criminal Code*, companies can minimize both legal and reputational risk.

What is Money Laundering under the *Criminal Code*?

The *Criminal Code* creates two separate anti-money laundering offences:

1. Concealment/conversion; and
2. Possession.

CONCEALMENT/ CONVERSION

The offence of concealment/conversion, as it relates to money laundering, is defined in section 462.31(1) of the *Criminal Code*:

> Every one commits an offence who uses, transfers the possession of, sends or delivers to any person or place, trans1ports, transmits, alters, disposes of or otherwise deals with, in any manner and by any means, any property or any proceeds of any property with intent to conceal or convert[1] that property or those proceeds, knowing or believing that all or a part of that property or of those proceeds was obtained or derived directly or indirectly as a result of
>
> (a) the commission in Canada of a designated offence,[2] or
>
> (b) an act or omission anywhere that, if it had occurred in Canada, would have constituted a designated offence. (emphasis added)

The offence may be prosecuted either by way of summary offence or by indictment with a maximum term of 10 years imprisonment. It is possible for the offence of concealment/ conversion to occur if an individual or a company is asked by a launderer to act as an agent. For example, an interior designer could arrange for the purchase of hundreds of thousands of dollars of furniture and building materials on behalf of a client, who completes each transaction in cash. If the designer is aware that the cash used for the transactions was earned through the commission of crime, the designer would have been used to perpetrate a money laundering scheme by facilitating the conversion of dirty money into a "clean" home renovation and would thereby be committing an offence under section 462.31(1) of the Criminal Code.

1 "convert" has been held to have its ordinary plain meaning (*R. v. Daoust*, [2004] 1 S.C.R. 217 at para. 63).

2 "designated offences" referenced in this section are defined in section 462.3(1) of the *Criminal Code* as any indictable offence under the *Criminal Code* or any conspiracy or attempt to commit such an offence. This would include offences such as drug trafficking, terrorism, fraud, tax evasion, burglary, deception, and blackmail (section 462 of the *Criminal Code*).

POSSESSION

Possession of property obtained from the commission of a criminal act is also relevant in the context of money laundering. Whereas concealment and conversion relate to the acts of a transferor of dirty money or property, the possession offence, defined in section 354(1) of the Criminal Code, relates to the receipt of dirty money or property:

> Every one commits an offence who has in his possession[3] any property or thing or any proceeds of any property or thing knowing that all or part of the property or thing or of the proceeds was obtained by or derived directly or indirectly from:
>
> (a) the commission in Canada of an offence punishable by indictment; or
>
> (b) an act or omission anywhere that, if it had occurred in Canada, would have constituted an offence punishable by indictment. (emphasis added)

If the subject matter of the offence exceeds $5,000, the offence is punishable by indictment with a maximum punishment of 10 years imprisonment. Continuing with the theme of home renovation, if a contractor is hired to build a house for a customer who pays in cash, and the contractor knows that the cash was earned by, for example, selling illegal drugs, the contractor would be committing the possession offence by accepting such payment.

THE DOCTRINE OF WILFUL BLINDNESS

It would be reasonable to assume that an honest business is unlikely to fall foul of either anti-money laundering offences because both require specific, guilty knowledge. In most cases, such an assumption would be correct; however, **the doctrine of wilful blindness allows for a person to be found guilty of a money-laundering offence by merely "looking the other way."** In *R. v. Briscoe*, the Supreme Court of Canada determined that "the doctrine of wilful blindness imputes knowledge to an accused whose suspicion is aroused to the point where he or she sees the need for further inquiries, but deliberately chooses not to make those inquiries."[4]

If a company employee has reason to believe that one of their customers is using the company to perpetrate a money-laundering scheme, but the employee does not make sufficient inquiries to prove or disprove their suspicion, a court could find that the employee (and therefore, the company) had the "knowledge" required by the *Criminal Code* anti-money laundering offences.

Again, drawing on the renovation example, if a contractor is asked to receive cash payments for his or her work from several different and seemingly unconnected people, it might be advisable for the contractor to inquire as to why the payments have been structured in this way. If no inquiries are made and in due course it is determined that such payments are part of a money-laundering scheme, a court may find that the contractor was wilfully blind for failing to make sufficient inquiries, and thus guilty of a money-laundering offence.

It is important to understand that although the doctrine of wilful blindness does impose a duty to inquire when faced with a suspicious circumstance, the doctrine does not imply an obligation on the part of companies to become private detectives, inspecting all aspects of their customers' affairs. Nevertheless, it is good practice for companies to train employees to spot suspicious activity and to instruct employees to make further enquires when a customer's conduct raises a suspicion. Wilful blindness may still apply if some inquiries are made but the accused still harbours a suspicion despite the inquiries.[5]

3 Section 4(3) of the *Criminal Code* describes what constitutes possession.
4 *R. v. Briscoe*, 2010 SCC 13 at para. 21.
5 *R. v. Rashidi-Alavije*, 2007 ONCA 712 at para 24.

IDENTIFYING MONEY LAUNDERING

Spotting suspicious transactions or behaviour can be challenging for businesses because norms of commercial behaviour vary widely. For example, a nightclub could engage in thousands of small cash transactions over the course of a single night, adding up to a large amount of money. This would not be cause for concern. The same could not be said for, say, a catering company engaging in such a pattern of transactions. Catering companies typically deal in larger single sums than nightclubs, but they deal with fewer clients, whose payments are made easily by cheque.

The nightclub/caterer example shows that, when looking for signs of money laundering, the context in which the transaction occurs or is attempted is a significant factor in assessing suspicion. As this will vary from business to business, and from one client to another, it is important for businesses to evaluate transactions based on the norms of their own particular line of business and industry practice. At the same time, however, businesses should keep in mind some general indicators that can help to identify money laundering to assess whether or not a transaction might give rise to reasonable grounds for suspicion. Some common indicators that have been linked to money laundering in the past include:

(a) the customer conducts the transaction(s) through an unusually large number of intermediaries, especially if some or all of those intermediaries are located overseas;

(b) the customer is involved in transactions that (i) are out of the normal course for industry practice, (ii) do not appear to be economically viable, (iii) are unnecessarily complex, or (iv) involve connections between disparate types of businesses (for example, a food importer dealing with an automobile parts exporter);

(c) the customer's transaction(s) involve a 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;

(d) the earnings for the customer's business seem to be well above the norm for that type of business or the customer earns an inordinately large salary as principal of a small business; or

(e) the customer's business deals in large amounts of cash instruments where there is no practical purpose for preferring cash.

It is important for businesses to evaluate transactions based on the norms of their own particular line of business and industry practice.

This is by no means an exhaustive list;[6] rather, it is a starting point for understanding what kinds of behaviour may point to money laundering. In many cases, one single indicator will not be enough to raise alarm, however, taken together, the presence of one or more indicators or a pattern of irregular behaviour might be cause for further inquiry.

Regulated Entities have reporting obligations if there are reasonable grounds to suspect that a financial transaction or an attempted financial transaction is related to the commission or attempted commission of a money-laundering offence or a terrorist-activity financing offence. Both Regulated Entities and non-regulated companies are also required to report to the Royal Canadian Mounted Police and/or Canadian Security Intelligence Service if they are in possession or control of property that they know or believe is owned or controlled by or on behalf of a terrorist or a terrorist group. However, there are no specific legislative requirements imposed on non-regulated companies regarding reporting of suspicious behaviour.

The presence of one or more indicators or a pattern of irregular behaviour might be cause for further inquiry.

6 Please refer to FINTRAC Guideline 2 for a more comprehensive list of common indicators that may point to a suspicious transaction. FINTRAC Guideline 2 can be found here: http://www.fintrac.gc.ca/guidance-directives/transaction-operation/Guide2/2-eng.asp.

How Can a Company Develop an Anti-Money Laundering Program?

So what can a non-regulated company do to minimize the legal and reputational risks related to money laundering? A first step for any company is to implement a formal anti-money laundering program. Although not all businesses operate under the same circumstances and an anti-money laundering program will have to be tailored to fit the nature, size and complexity of a business operation's needs, there are essentially four components to implementing a successful program:

RISK ASSESSMENT

1. In order to develop a strong anti-money laundering program, you should consider undertaking a risk assessment to identify the risks, potential threats and vulnerabilities to money laundering and terrorist financing that your business is exposed to given the size and nature of the business.

DESIGNATED PERSON

2. Companies may designate a specific person to take responsibility for dealing with issues related to, or suspicions of, money laundering and terrorist financing. The designated person's job would include administering an anti-money laundering program and the person could wear many hats within the organization as long as that person has sufficient authority and access to resources (e.g. access to senior management and/or the board of directors) in order to discharge their responsibilities effectively.

POLICIES AND PROCEDURES

3. Unlike Regulated Entities, non-regulated entities are not required to implement an anti-money laundering program. The freedom to choose to adopt customized procedures to deal with potential money-laundering risks is a benefit for non-regulated companies, but it is also a burden. Unless management has experience dealing with money-laundering issues, deciding on the appropriate level of vigilance and caution can be a challenge. When approaching this task, companies will find it helpful to return to the end goal of any anti-money laundering program: minimizing the risk posed by the offences defined in the *Criminal Code*.

   Generally, a robust anti-money laundering program will include policies and procedures that require certain due diligence on customers and other counterparties. These could include ascertaining the identity of individual clients or authorized signers, confirming the existence and the beneficial ownership of entity clients, obtaining information on clients' sources of funds and sources of wealth where there are concerns about the legitimacy of client funds. An effective anti-money laundering program will also include procedures for monitoring client transactions for suspicious or fraudulent activities (or determining if they are consistent with the expected purpose and intended nature of your dealings with the client), as well as procedures for dealing with law enforcement where concerns arise about a potential criminal activity.

   By learning more about the anti-money laundering provisions in the *Criminal Code* and how law enforcement agencies enforce those provisions, companies can craft policies and procedures to help them stay profitably clean.

ONGOING EMPLOYEE TRAINING

4. Companies may provide employees with initial and continuous ongoing training sessions to educate them about money laundering, advise them of the company's policies, procedures and risks of exposure to money laundering and teach them how to spot and take action in the face of suspicious activity.

Conclusion

A company's anti-money laundering program is only as strong as its employees' ability to identify suspicious activity. This primer has identified some general money laundering indicators that could apply to any business, but it is important for a company to identify indicators specific to its business, industry and commercial practices and community. Once a set of specific indicators has been identified, the designated person can organize an initial training session to familiarize employees with the relevant indicators. Annual or more frequent refresher sessions can help keep the indicators on the radar of employees.

Such sessions may also provide a forum for the designated person to gather feedback and refine the company's set of money laundering indicators and policies.

A company's anti-money laundering program is only as strong as its employees' ability to identify suspicious activity.

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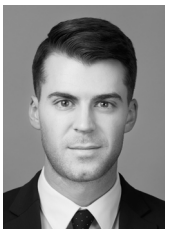

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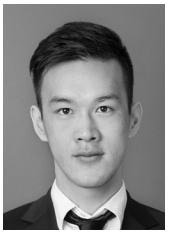

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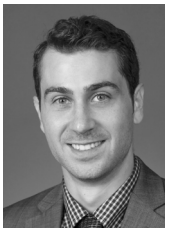

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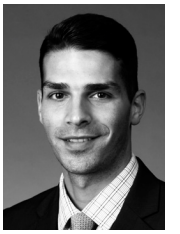

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