PROCEEDS OF CRIME (MONEY LAUNDERING)

Recently, the federal Government published in the Canada Gazette Part II, volume 127, No. 4 on February 24, 1993 regulations under the Proceeds of Crime (Money Laundering) Act which will come into force March 26, 1993 (see attached). These regulations will impose record keeping and related requirements on financial institutions, foreign exchange dealers, securities dealers, life insurers and others to help enforce various criminal statutes. The Act and the Regulations are part of a co-ordinated international effort to control money laundering.

The purpose of this interpretation bulletin is to provide guidance in interpreting the federal Government Money Laundering regulations and advise of forthcoming proposed new IDA Regulation 1300.2A which relates to compliance with the federal legislation.

1. **What is Money Laundering?**

   Money laundering is a process in which the proceeds of organized crime are converted into legitimate funds using complex transactions through the financial institution deposit and withdrawal system. The process is initiated by the deposit of proceeds of crime into the financial system. Complex transactions are then used to obscure the audit trail of the funds so they will appear to be legitimate when they are withdrawn.

   There are three stages of money laundering during which there may be numerous transactions made by launderers that could alert an investment dealer to criminal activity: **Placement** - the physical disposal of cash proceeds derived from illegal activity.

   **Layering** - separating illicit proceeds from their source by creating complex layers of financial transactions designed to disguise the audit trail and provide anonymity.

   **Integration** - the provision of apparent legitimacy to criminally derived wealth. If the layering process has succeeded, integration schemes place the laundering proceeds back into the economy in such a way that they re-enter the financial system appearing to be normal business funds.

2. **What is the potential abuse of the Investment Industry in the Money Laundering Process?**

   Because investment business is not generally cash based, it is less at risk from the initial **placement** of criminally derived funds than mainstream banking. Most payments are
made by way of cheque from another financial institution and it can therefore be assumed that the first stage of money laundering has already been achieved. Nevertheless, the purchase of investments for cash is not uncommon and therefore the risk of investment business being used at the placement stage cannot be ignored.

Investment business is arguably more at risk from the second stage of money laundering being the *layering* process. Unlike laundering via the mainstream banking networks, investment business allows the launderer to change the form of funds, not just from cash in hand to cash on deposit but from money in whatever form to an entirely different asset. Investments that are cash equivalents, such as bearer bonds and similar investments in which ownership can be evidenced without reference to registration of identity, may be particularly attractive as a vehicle for laundering money.

Investment transactions incorporate an added attraction to the launderer in that the alternative asset is normally highly liquid. The ability to liquidate investment portfolios containing both lawful and illicit proceeds, while concealing the criminal source of the latter, combined with the huge variety of investments available, and the ease of transfer between them, offers the sophisticated criminal launderer an ideal route to effective *integration* into the legitimate economy.

3. **What is the purpose of the "Money Laundering" regulations?**

   These regulations are intended to establish the minimum records to be maintained by Members and other financial institutions and financial businesses to support detection, investigation and prosecution of money laundering offenses under the Criminal Code, the Food and Drugs Act and the Narcotic Control Act. The *Proceeds of Crime (Money Laundering) Act* stipulates that anyone contravening or failing to comply with the Act is guilty of an offence and liable to fine or imprisonment.

   The federal Government Money Laundering regulations are effective March 26, 1993 and apply for all records kept by securities dealers. Forthcoming Association regulations will embody the federal rules as they specifically relate to member firms.

   The majority of records required by the regulations for the securities industry are currently provided for in IDA Regulation 200 - Minimum Books and Records. Proposed new IDA Regulations 1300.2A and 200.1(n) and (o), will specifically address the identification of customers of Members, and the monitoring and recording of large cash transactions, in order to provide an audit trail for investigations of suspicious client activity.

4. **What are large cash transactions?**

   The government regulations apply to large cash transactions in which cash in an amount of $10,000 or more is received by a Member firm. Although securities dealers do not deal with cash deposits on a regular basis, a "Declaration of Funds" form has been developed for Members to record clients' large cash transaction deposits.

   The "Declaration of Funds" requires the following client information:

   · name of the individual from whom the cash is received;
   · identity of the individual by reference to residence;
   · the individual's address, occupation and nature of principal business;
· the date and the nature of the transaction;
· the numbers of the accounts which are affected by the transaction;
· amount of cash received and the currency; and
· information as to cash received on behalf of third persons.

Attached is a suggested copy of a "Declaration of Funds" form prepared by the IDA and recommended to be used by Member firms.

5. **How is the identity of an authorized individual verified?**

The Money Laundering regulations provide the following three alternatives for securities dealers to verify, within six months of opening an account, the identity of the individuals authorized to give instructions in respect of an account. **This requirement is effective for all new accounts opened by a securities dealer after March 26, 1993:**

   a) **Physical Verification**

   The signature of an authorized individual is compared to the signature on a driver's licence, passport, birth certificate, or similar document. This can be accomplished in the initial meeting between the registered representative and the client when the new account application form is completed.

   b) **Cheque verification**

   A responsible person at the Member firm may verify an authorized individual's identity by ensuring that a cheque drawn by the individual on the account has cleared.

   The cashiering department, which receives the cheques and records the payments in the client's account, can meet this requirement by ensuring the bank account on cheques received is the same as the bank account recorded in the client account file.

   c) **Bank Reference Check**

   Members can also verify the identity of an authorized person by ensuring the bank account number disclosed on the new account application form belongs to the individual.

   This alternative allows a responsible person at a Member firm to make a direct bank reference check with the bank, confirm on-line through credit check facilities, or in some other similar way, verify the bank account listed belongs to the authorized individual in respect of the account.

   Note that the government has determined that the client's identity must be verified within six months of opening an account, regardless of which method of verification prescribed is used.

6. **Who must be identified?**

All individuals authorized to give instructions in respect of a client's account must be identified in the manner described above.

However, to the extent that an account is owned or operated by a financial institution
(such as Canadian chartered banks, co-operatives, insurance companies, trust and loan companies) or dealers in securities, investment counsellors or portfolio managers who are registered in that capacity under a provincial securities act, a bank account reference and verification of the identity of the individual authorized in respect of the account are not required. It is the responsibility of the above-noted institution or securities registrant to comply with the record-keeping requirements of the money laundering regulation and not the Member firm.

7. **What records are required to be kept by Members?**

The following records are to be maintained by Members:

a) **Signature of Authorized Individuals**

Members are required to obtain the signature of all individuals authorized to give instructions in respect of an account on a signature card, account agreement or new account application form. (A limit of three weeks is a general guideline for the registered representative to obtain the client's signature. This is a reasonable length of time to mail the applicable form to the client, have it signed, and returned to the Member firm.)

b) **Account number of a bank, trust company, credit union or caisse populaire**

To develop an audit trail for client funds, the chequing or savings account number of a deposit taking institution used by the authorized individuals is to be recorded.

c) **Client documentation and monthly statements**

Dealers are required to maintain client files including new account application forms, trade confirmations, account agreements, client correspondence, and copies of all monthly statements sent to clients. These requirements as set out by the government regulations are currently industry regulations regarding the maintenance of client records. All dealers complying with the minimum record requirements pursuant to IDA Regulation 200.1 will be in compliance with the government regulations.

d) **Large cash transaction records**

Records of all cash transactions greater than $10,000 are to be kept for each account. The money laundering regulations also specify that multiple transactions on the same day on behalf of the same person should be treated as a single transaction for the purpose of determining if the transaction should be recorded as a large cash transaction. These transactions are to be recorded on the prescribed "Declaration of Funds" for each client (see attached).

8. **Can records be maintained in automated form?**

Members will meet the record retention requirements by maintaining, on file, computer coded or microfiche records of client documents, monthly statements, and large cash transaction records. Member firms must be able to readily provide hard copies of such records upon request.

9. **What is the required term of client record retention?**

Industry regulations currently require records as prescribed by the IDA Guide to Record Retention Requirements for IDA Members, dated 1982 to be retained for seven
years. This requirement is in excess of the government regulations which require records to be retained for five years, thus all dealers who comply with these requirements will also be in compliance with the government regulation.

10. **Designated Director or Other Officer.**

The Federal Money Laundering regulations and proposed new IDA Regulation 1300.2A will require that Members designate a director or other officer who should be responsible for compliance by the Member and its employees and agents with the money laundering regulations.

It is **recommended** that member firms formulate and adopt a clear policy statement in relation to money laundering, based on the current federal statutory requirements. This statement should be communicated in writing to all management and relevant staff involved in investment operations and should be reviewed on a regular basis.

11. **How do you recognize suspicious transactions?**

At present there is no Canadian Federal Government or Association requirement for the reporting of suspicious transactions. It is left to the discretion of the designated person responsible with compliance with the regulation to report any suspicious transactions to the proper law enforcement agencies.

The types of transactions which may be used by a money launderer are almost unlimited, and therefore makes it difficult to define a suspicious transaction. **However, a suspicious transaction will often be one which is inconsistent with an investor's known, legitimate business or personal activities or with the normal business for that type of investor.** The first key to recognition is knowing enough about the investor's business or investment objectives to recognize that a transaction, or series of transactions, is unusual.

To assist in preventing the investment industry from being used for money laundering the following questions should be addressed before entering into the transaction:

- Is the investor personally known?
- Is the transaction in question in keeping with the investment objectives of the investor?
- Is the transaction in keeping with normal practice in the market to which it relates, i.e. with reference to market size and frequency?
- Is the role of any intermediary involved in the transaction unusual?
- Is the transaction to be settled in the normal manner?
- Are there other transactions linked to the transaction in question which could be designed to disguise money and divert it into other forms or other destinations and beneficiaries?

Some situations are considered to be more prone to money laundering activities. Additional enquiries may need to be made in situations which:

- payment is offered in cash;
- payment is by way of third party cheque without any apparent connection with the
prospective investor;

payment is by cheque where there is a variation between the account holder, the
signatory and the prospective investor;

settlement either by registration or delivery of securities is to be made to an
unverified third party;

settlement is to be made by way of bearer securities from outside a recognized
clearing system.

Appropriate procedures should be introduced which generate a level of awareness and
vigilance to enable a report to be made to the designated person responsible for
compliance with the regulations if suspicious transactions are encountered. The
designated person should be in a position to provide direction on suspicious transactions
both internally and to law enforcement agencies.

Any questions regarding this bulletin should be directed to Louis P. Piergeti, Director of
Compliance at (416) 364-6133.

PLEASE DISTRIBUTE TO ALL INTERESTED PARTIES IN YOUR FIRM

DECLARATION OF FUNDS
Large Cash Transactions

Date:

To:  (Member Firm Name)

Branch:

PART A         Instruction:  If cash deposited is on behalf of a third party, then Part B of this form
must also be completed in addition to Part A.

1. I understand that I am making this declaration for my own protection as well as the protection of
(member firm name). This declaration is required by the regulations of the Investment Dealers
Association of Canada and certain stock exchanges as a precaution against money laundering. Large
cash transaction records are required pursuant to the Federal Government "Proceeds of Crime" Money
Laundering Act and Regulations.

2. Consent is hereby given to (member firm name) and any self-regulatory organization having
jurisdiction over it, to disclose this transaction to government authorities, agencies and securities self-
regulatory organizations.

3. I declare that cash totalling $ _______________ in ______________ funds was deposited
by me today at the above noted branch to account number(s);
                                        ______________  \  ______________  \  ______________.

4. Principal business: _______________________________    Occupation:

5. Nature of the transaction: ___________________________________________________

Name:     ___________________________________________    Address:

Signature: ________________________________

____________________________
____________________________
____________________________
PART B  Instruction: If the cash transaction is carried out on behalf of a third party, complete Subsection B1.

B1
Name of third party: ____________________________________________  Address of party: ____________________________________________

Occupation of party: ____________________________________________  Principal business of third party: ____________________________________________

B2
I declare that a large transaction record pursuant to the Proceeds of Crime (Money Laundering) Act (Canada) is being kept with respect to the receipt of the cash from (name of third party) ____________________________________________________________

Name (please print): ____________________________________________  Signature: ____________________________________________

For Internal Use Only:
Physical Customer Identification: (Minimum one)

_____ Birth Certificate  ____________________________________________

_____ Driver's Licence  ____________________________________________

_____ Passport Number  ____________________________________________

_____ Other (Specify)  ____________________________________________

Status/Residence: _____ Canadian  _____ U.S.  _____ Other
Accepted by: ____________________________________________