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## **DOF RESPONSE TO FATF RECOMMENDATIONS**

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*By Terrance S. Carter, Nancy E. Claridge and Sean S. Carter\**

### **A. INTRODUCTION**

Canada's Department of Finance released its Assessment of Inherent Risks of Money Laundering and Terrorist Financing in Canada (The "Report")<sup>1</sup> on July 31, 2015. The Report is a response to Financial Action Task Force ("FATF") standards and recommendations that encourage member countries to conduct internal assessments of money laundering and terrorism-financing risks. These guidelines are published in International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations.<sup>2</sup> The FATF is an international organization responsible for setting and monitoring international standards for combatting money laundering and the financing of terrorism. The Report will constitute part of the FATF Mutual Evaluation of Canada, which will take place in October/November 2015, and is also intended to communicate risk information to entities, such as financial institutions, that have reporting requirements pursuant to the Proceeds of Crime (Money Laundering) and Terrorist Financing Act ("PCMLTFA").

### **B. METHODOLOGY**

In order to assess risk in Canada, the Report employed "rigorous and systematic analysis of qualitative and quantitative data and expert opinion about money laundering and terrorist financing" to identify core

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<sup>1</sup> Department of Finance Canada (2015), *Assessment of Inherent Risks of Money Laundering and Terrorist Financing in Canada* <<http://fin.gc.ca/pub/mltf-rpcfai/index-eng.asp>>.

<sup>2</sup> FATF (2012), *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations*, online <<http://www.fatf-gafi.org/topics/fatfrecommendations/documents/fatf-recommendations.html>>.

components of money laundering and terrorist financing threats, as well as the inherent vulnerabilities of the Canadian financial system.<sup>3</sup> These assessments were then used to develop criteria to rate threat levels by matching- the threat of money laundering, and/or terrorist financing, with inherent vulnerabilities of various Canadian sectors. Threat levels and vulnerabilities were then considered in light of the consequences of said illicit activities to arrive at an overall threat level.

## C. MONEY LAUNDERING AND TERRORIST FINANCING THREATS

With regard to money laundering, the Report identified a “broad range of profit-oriented crime conducted by a variety of threat actors in Canada.”<sup>4</sup> These threat actors varied from petty criminals to large transnational organized crime groups. Specifically, the Report analyzed twenty-one distinct money laundering threats on the basis of four criteria:

- 1) *Sophistication*: the extent to which the threat actors have the knowledge, skills and expertise to launder criminal proceeds and avoid detection by authorities.
- 2) *Capability*: the extent to which the threat actors have the resources and network to launder criminal proceeds.
- 3) *Scope*: the extent to which threat actors are using financial institutions, DNFBPs and other sectors to launder criminal proceeds.
- 4) *Proceeds of Crime*: the magnitude of the estimated dollar value of the proceeds of crime being generated annually from the profit-oriented crime.<sup>5</sup>

Upon being assessed according to these criteria, the twenty-one money laundering threats were classified as: very high, high, medium or low. Those that were classified as very high included: Capital Markets Fraud, Commercial Fraud, Corruption and Bribery, Counterfeiting and Piracy, Illicit Drug Trafficking, Mass Marketing Fraud, Mortgage Fraud, Third-Party Money Laundering and Tobacco Smuggling and Trafficking.

With regard to terrorist financing threats, the Report acknowledged that countering terrorism is a priority in Canada and that “the transfer of suspected terrorist funds to international locations has been conducted through a number of methods, including the use of MSBs, banks and non-profit organizations

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<sup>3</sup> *Supra* Note 1 at 15.

<sup>4</sup> *Ibid* at 18.

<sup>5</sup> *Ibid* at 19.

(NPOs), as well as smuggling bulk cash across borders.”<sup>6</sup> While Canada has fifty-four terrorist entities listed under the *Criminal Code*, and thirty-six listed under the *Regulations Implementing the United Nations Resolutions on the Suppression of Terrorism*, not all of these entities pose similar terrorist financing threats to Canada (e.g., some entities may pose threats of different terrorist offences rather than simply terrorist financing). Overall, the report identified ten terrorist groups and separate classification of individuals, loosely classified as “foreign fighters or extremist travelers” and assessed their potential for terrorist financing according to the following criteria:

- 1) *Sophistication*: the extent of the threat actors’ knowledge, skills and expertise to conduct sustainable, long-term and large-scale TF operations in Canada without being detected by authorities.
- 2) *Capability*: the extent of the threat actors’ network, resources and overall capability to conduct TF operations in Canada.
- 3) *Scope of Terrorist Financing*: the extent to which the threat actors have a network of supporters and sympathizers within Canada and globally.
- 4) *Estimated Fundraising*: the estimated value of their TF activities in Canada.
- 5) *Diversification of Methods*: the diversity and complexity of TF methods related to the collection, aggregation, transfer and use of funds in Canada.
- 6) *Suspected Use of Funds*: the extent to which funds raised in Canada or overseas by terrorist actors are suspected to be used against Canadian interests in Canada or overseas.<sup>7</sup>

According to these criteria, the ten specified terrorist groups and a new group of individuals described as “foreign fighters or extremist travelers” (the FATF standards for money laundering and terrorist financing have not yet identified these individuals as a distinct categorization) were classified as posing relative amounts of low, medium or high risks of terrorist financing. The Report also provided more detailed information on a number of these groups with regard to what is presently known about their terrorist financing methods (e.g., fundraising networks).

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<sup>6</sup> *Ibid* at 27.

<sup>7</sup> *Ibid* at 31.

## D. INHERENT VULNERABILITES FOR MONEY LAUNDERING AND TERRORIST FINANCING

Having assessed and classified threats to Canada, the Report subsequently identified and assessed Canada's particular vulnerabilities to such threats. "Internationally, Canada is recognized as a multicultural and multiethnic country with a stable economy and strong democratic institutions. Although these features of Canada are positive, some can be subject to criminal exploitation."<sup>8</sup> In this regard, twenty-seven economic sectors and financial products were assessed using these five criteria:

- 1) *Inherent Characteristics*: the extent of the sector's economic significance, complexity of operating structure, integration with other sectors and scope and accessibility of operations.
- 2) *Nature of Products and Services*: the nature and extent of the vulnerable products and services and the volume, velocity and frequency of client transactions associated with these products and services.
- 3) *Nature of the Business Relationships*: the extent of transactional versus ongoing business, direct versus indirect business relationships and exposure to high-risk clients and businesses.
- 4) *Geographic Reach*: the exposure to high-risk jurisdictions and locations of concern.
- 5) *Nature of the Delivery Channels*: the extent to which the delivery of products and services can be conducted with anonymity (face-to-face, non-face-to-face, use of third parties) and complexity (e.g., multiple intermediaries with few immediate controls).<sup>9</sup>

According to these criteria, five sectors were rated as being "very high" in terms of overall vulnerability, and sixteen were rated as "high". Importantly, these sectors and products are also subject to mitigation measures and close supervision, which this assessment did not take into account. The sectors and products that were judged to have very high vulnerability are: Corporations, Domestic Banks, Express Trusts, National Full-Service MSBs, and Small Independent MSBs.

Interestingly, charities were assessed to have a high vulnerability for terrorist financing. The Report found that those charities that are most vulnerable are those that provide services in areas that are in close proximity to terrorist threats. Moreover, the Report found that many financial transactions conducted by registered charities can be done with a high degree of anonymity and/or complexity. The Report also

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<sup>8</sup> *Ibid* at 31.

<sup>9</sup> *Ibid* at 31.

provided examples of inherent risk scenarios for various sectors. With regard to registered charities, it cited diversion of funds as the most common threat of terrorist financing. Other risk scenarios included: Affiliation with Terrorist Entities, Abuse of Programming, Support of Recruitment and False Representation and Sham Organizations.

## E. CONCLUDING COMMENTS

The Report was undertaken to act as an initial assessment of money-laundering and terrorist financing threats, as well as inherent vulnerabilities, in the context of the Canadian financial sector. It is described as an important step in achieving compliance with FATF recommendations, as well as a critical education tool for reporting entities interested in trends and challenges in the anti-terrorism and money laundering landscape. In addition to a risk assessment framework, the report also provides specific examples of threats and risks for specific sectors and financial products. This will presumably act as a starting point for the upcoming Mutual Evaluation of Canada by FATF later in 2015.

This Report also serves as an important reminder to the Canadian charitable sector of the government's priorities in these areas, and the perceived need for improvement in the current Canadian legislative, regulatory and enforcement framework to address the threats of terrorist financing and money laundering. In general, the Report may be an indicator of where resources will be allocated in the future by the government in order to address these issues and what oversight measures may be taken by a variety of regulators and law enforcement agencies. The Canadian charitable sector needs to take note, as the sector is perceived as being "highly vulnerable" to various types of abuse, in particular posing a particular threat in the areas of money laundering and terrorist financing related activities. Given the anticipated legislative, regulatory and enforcement related ramifications of the Report beyond the multi-lateral policy making institutions, Canadian charities need to continue to take proactive steps to stay apprised of the increasing government focus on the sector and its perceived vulnerabilities.