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Hidden Beneficial Ownership and Control: Canada as a Pawn in the Global Game of Money Laundering

With increasing concern about tax evasion, corruption, money laundering, the use of shell companies and offshore legal arrangements, it is time for a central publicly accessible registry to unmask the beneficial owners of corporations and certain trusts.

Denis Meunier

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THE STUDY IN BRIEF

Official estimates of money laundering in Canada range from \$5 billion to \$100 billion. Offences such as drug trafficking, fraud, tax evasion, smuggling and corruption are fuelling the laundering of dirty money. While many methods and techniques may be used to hide ill-gotten gains from tax authorities and police, launderers often use corporations and trusts to co-mingle dirty money with legitimate funds to flow them through these entities' bank accounts or brazenly use the entity to exclusively conduct illegal activities.

The “secret sauce” in this recipe is the creation of legal arrangements that hide the beneficial owner of the corporation, partnership or trust that exercises significant control over the entity. Indeed, with professional knowhow, complex structures can be created in Canada, or offshore, that will slow down or stop any intrepid investigator trying to connect the dirty money to the beneficial owner.

The focus of this *Commentary* is to show how the lack of beneficial ownership transparency facilitates the use of corporations and trusts for illicit purposes. At present, there are no requirements to disclose beneficial ownership when creating a corporation. Nominee shareholders and directors can be appointed without disclosing the ultimate beneficial owner or the nominator. For trusts, there are also no requirements to identify the parties when registering. As a result, Canada fares poorly on international standards for disclosing beneficial ownership. Lack of beneficial ownership transparency is not only a structural flaw in Canada's corporate registration system (federally, provincially and territorially) and, consequently, in its anti-money laundering and anti-terrorist financing measures, but it paints Canada as an international laggard and as a financial-secrecy jurisdiction.

However, there now is a global momentum, led by the Europeans, to make beneficial ownership registries accessible to the public, and trusts under certain conditions, to more effectively address the threats posed by money laundering, terrorist financing, corruption and tax evasion.

This *Commentary's* recommendations are for the federal government, in collaboration with the provinces and territories, to establish a central publicly accessible beneficial ownership registry of corporations and certain trusts; require all reporting entities under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* to identify beneficial ownership information; place the onus on corporations and trusts to truthfully and fully disclose beneficial ownership information; and follow the European example by keeping Canada current with the international standards, commitments and trends on beneficial ownership transparency.

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Official estimates of money laundering in Canada range from \$5 billion to \$100 billion. Offences such as drug trafficking, fraud, tax evasion, smuggling and corruption are fuelling the laundering of dirty money.

The taxes that are evaded become a burden for compliant taxpayers and corporations who shoulder a disproportionate amount of government expenditures and deprive citizens of better services, such as education, healthcare, policing and national security. The tax gap from non-compliance alone was estimated in 2014 to reach \$14.6 billion, and that doesn't consider corporate tax non-compliance.¹ Like the taxes evaded, the billions that are generated from other crimes find their way into the domestic economy when not hidden offshore. Illicit financial flows upset the level playing field and competitiveness of honest business persons. Dirty money finds its way through bribes to officials, with taxpayers dishing out more money to pay for inflated public infrastructure projects, as was seen in the Charbonneau Commission inquiry in Quebec. The impacts of money laundering are significant and insidious.

While many methods and techniques may be used to hide ill-gotten gains from tax authorities and police, launderers often use corporations and trusts to co-mingle dirty money with legitimate funds to flow them through these entities' bank accounts or brazenly use the entity to exclusively conduct illegal activities. The "secret sauce" in this recipe is the creation of legal arrangements

that hide the beneficial owner of the corporation, partnership or trust that exercises significant control over the entity. Indeed, with professional knowhow, complex structures can be created in Canada, or offshore, that will slow down or stop any intrepid investigator trying to connect the dirty money to the beneficial owner. The focus of this *Commentary* is to show how the lack of beneficial ownership transparency facilitates the use of corporations and trusts for illicit purposes.

At present, there are no requirements to disclose beneficial ownership when creating a business corporation. Nominee shareholders and directors can be appointed without disclosing the ultimate beneficial owner or the nominator. For trusts, there are also no requirements to identify the parties when registering.²

As a result, Canada fares poorly on international standards for disclosing beneficial ownership. While the World Bank rates Canada as the second-best place to start a business, the Tax Justice Network rates it the 21st worst "financial-secrecy jurisdiction," a place where people or entities can create and operate secretive structures for tax- and law-dodging purposes (World Bank 2017; Tax Justice Network 2018). Lack of beneficial ownership transparency is not only a structural

The author thanks Jeremy Kronick, Paul Bourque, Greg Cowper, John Crean, David M. D'Amour and members of the C.D. Howe Institute's Financial Services Research Initiative for comments on an earlier draft. The author retains responsibility for any errors and the views expressed.

1 <https://www.canada.ca/en/revenue-agency/news/2018/06/tax-gap-estimates-in-canada.html>.

2 Federal Budget 2018 announced new rules, starting in 2021, for the identification of settlors, trustees, beneficiaries and protectors (if any) of trusts, applicable to express trusts that are resident in Canada and to non-resident trusts that are currently required to file a T3 return.

flaw in Canada's corporate registration system and, consequently, in its anti-money laundering and anti-terrorist financing measures, but it paints Canada as an international laggard and as a financial-secrecy jurisdiction (Transparency International 2018).

Regulations under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* require certain reporting entities, including financial entities, life insurers, securities dealers and money services businesses (herein referred to as Financial Service Providers (FSPs)) to obtain and take reasonable measures to confirm the identity of their beneficial owners. The same requirement applies to other arrangements such as trusts; i.e., the settlors, trustees and beneficiaries.^{3,4} However, these obligations exist without the benefit of a publicly accessible and centrally integrated beneficial ownership registry for corporations, or a registry of trusts, creating a difficult compliance burden for the private sector. This *Commentary* identifies four weaknesses with the current regulations: placing the onus on reporting entities to obtain beneficial ownership information; allowing for costly and ineffective procedures that do not ultimately verify the identity of the beneficial owner; a narrow scope, in that they do not apply to all reporting entities; and scrutinizing individuals more carefully than corporations and trusts.

In December 2017, Canada's finance ministers announced priority action on determining beneficial ownership of corporations (Finance Canada 2017). On February 7, 2018, the federal Department of Finance released a consultation paper on Reviewing

Canada's Anti-Money Laundering and Anti-Terrorist Financing Regime seeking Canadians' views on "... how to improve corporate ownership transparency and mechanisms to improve timely access to beneficial ownership information by authorities while maintaining the ease of doing business in Canada (Finance Canada 2018)." In Budget 2018, the federal government announced it would be taking measures to enhance income tax reporting requirements for certain trusts and would introduce legislative amendments to the *Canada Business Corporations Act* to strengthen the availability of beneficial ownership information.⁵ When the House of Commons Standing Committee on Finance wrapped up its hearings on the five-year review of the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* on June 20, 2018, it highlighted the lack of transparency of beneficial ownership of corporations and trusts.⁶

While all these pronouncements, reviews and planned actions are welcome in the fight against illicit money flows, Canada has been offside internationally and never compliant with the standards set by the multilateral Financial Action Task Force on beneficial ownership for at least 15 years.⁷ While Canada's image as an offshore secretive jurisdiction might be shocking to most Canadians, it isn't to those who nefariously use the lax corporate registration systems to thwart the law and tax authorities.

However, there now is global momentum, led by the Europeans, to make beneficial ownership registries accessible to the public to more effectively

3 PCMLTFA (Last amended 2017).

4 PCMLTFR (2017).

5 Department of Finance Canada. Budget 2018. "Cracking-Down-on-Tax-Evasion-and-Combatting-Tax-Avoidance."

6 See <https://www.ourcommons.ca/Committees/en/FINA/StudyActivity?studyActivityId=9933703>.

7 The FATF standards on beneficial ownership can be summarized as two significant technical standards (Recommendations 24 and 25) and one effectiveness criterion (IO5). Against these three criteria, the FATF in 2016 assessed Canada as partially compliant, non-compliant and having achieved a low level of effectiveness, respectively.

address the threats posed by money laundering, terrorist financing, corruption and tax evasion. This *Commentary* recommends that Canada follow the European example and implement such publicly accessible beneficial registries of corporations and certain trusts. The federal, provincial and territorial governments should: make beneficial ownership registries of corporations and certain trusts publicly accessible; require all reporting entities under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* to identify beneficial ownership information; place the onus on corporations and trusts to truthfully and fully disclose beneficial ownership information; and keep Canada current with the international standards, commitments and trends on beneficial ownership transparency.⁸

WHAT IS MONEY LAUNDERING?

Definitions of money laundering vary slightly among jurisdictions or international organizations, but the core message is the same as the one given by the UN Office on Drugs and Crime. It's a "process by which a person conceals or disguises the identity or the origin of illegally obtained proceeds so that they appear to have originated from legitimate sources."⁹

As a process, laundering money has three phases. First, it moves criminal proceeds into the financial system. This first phase is called placement. In its simplest form, this could be a cash deposit into a bank. The second phase is called layering because it involves complex financial transactions to camouflage the money's illegal source. Among popular layering methods are multiple wire transfers, loans, purchasing life insurance or investing in securities. Finally, the third phase,

integration, returns the money to the criminal in a manner that appears legitimate, such as investing in commercial real estate or a business that can further serve as a money laundering tool.

It is impossible to know exactly how much money is laundered in Canada annually, but the Senate Committee on Banking and Trade reported in 2013 that: "The United Nations estimates that the amount of money laundered globally each year is between 2 percent and 5 percent of the world's gross domestic product..." If those percentages were applied to Canada's 2016 gross domestic product of approximately \$2 trillion, it would represent a range of \$40 billion to \$100 billion of dirty money laundered. The RCMP's estimates are more modest. In 2011, it estimated that between \$5 billion and \$15 billion was laundered. Even if the lower ranges are accurate, they nonetheless have significant legal and tax implications.

The movies and TV have often offered simplistic descriptions of money laundering. Money laundering was often illustrated by drug trafficking profits carried in a hockey bag and swung over the bank teller's counter to be deposited into the financial system with few questions asked. In more contemporary plots, proceeds from sophisticated frauds are transferred electronically to shell corporations with offshore accounts at the press of a button.

These two scenarios, however crude, aren't far from the money laundering methods still used in today's world (German 2018). Money laundering has evolved as has any business strategy. It adapts to its environment as new laws and technologies are introduced, utilizes novel methods and techniques, makes use of professionals, pursues partnerships, finds opportunities on the global stage and takes

8 In the case of trusts, this would include information about the settlors, the trustees, the beneficiaries and the protector (if any).

9 UN Office on Drugs and Crime and International Monetary Fund (2005).

advantage of the adversary's (i.e., law enforcement and the justice system) vulnerabilities.¹⁰

WHAT CONSTITUTES MONEY LAUNDERING IN CANADA?

In order to convict a suspected money launderer, the Crown must first prove that the suspected money launderer used, transferred, transported or otherwise dealt with property or proceeds of property.

Secondly, the Crown must prove that the property or proceeds of property were obtained from the commission of a "designated offence." With the few exceptions, described in the Regulations Excluding Certain Indictable Offences from the Definition of "Designated Offence," any offence under the Criminal Code of Canada or any Act of Parliament that can be prosecuted as an indictable offence, or a conspiracy to commit such an offence, is defined as a "designated offence" for the purposes of money laundering in Canada.¹¹ "Designated offences" include fraud, embezzlement, theft, robbery, smuggling, drug trafficking, human smuggling, human trafficking, counterfeiting, loan sharking and illegal gambling. Until July 11, 2010, tax evasion wasn't a "designated offence." That meant that under the *Income Tax Act* or the *Excise Tax Act* (e.g., for HST/GST) a tax evader who had not committed any other crime could not be prosecuted for money laundering. The harshest penalty for a tax evasion conviction was, and still is today, a maximum of five years in jail and a court fine of 200 percent of the taxes evaded. However,

since July 12, 2010 tax-evasion offences may now also be prosecuted as money laundering offences.

The consequences for a money laundering conviction are much harsher. Jail time can reach a maximum of 10 years. If the proceeds in relation to the money laundering offence cannot be forfeited after the money launderer has been convicted, the court can impose a fine equal to the value of the proceeds that would have been forfeited. If the convicted money launderer is in default of paying the fine imposed, the court must impose a term of imprisonment. The term of imprisonment is based on a sliding scale and depends on the amount of the fine that is the subject of the default. The maximum term of imprisonment is between five and 10 years where the fine exceeds \$1 million. This additional term of imprisonment in default is to be served consecutively to any other term of imprisonment imposed on the offender.

Thirdly, the Crown must show that the accused knew or believed that all or part of the property or proceeds was obtained or derived by the commission of a designated offence. Lastly, the Crown must show that the accused dealt with the property or proceeds with the intent to conceal or convert the property or proceeds.

They may conceal the source of the proceeds in innumerable ways, depending on the crime. In drug trafficking, criminals at retail and mid-level distribution tend to accumulate cash and that creates its own set of problems for placement in the financial system. In some instances, innocent-appearing collaborators are used to make multiple

10 As an example, money laundering techniques have evolved with new technologies including the use of virtual currencies and open-loop, pre-paid access cards. When new reporting requirements were introduced for large cash transactions of \$10,000 or more, money launderers adapted their deposit methods by breaking down the deposits into smaller amounts and smurfing (using unsuspected individuals to make deposits under \$10,000 on their behalf).

11 Regulations Excluding Certain Indictable Offences from the Definition of "Designated Offence" (Current to January 18, 2018 and last amended on July 12, 2010).

cash deposits in financial institutions or money services businesses under the \$10,000 legally reportable threshold (known as smurfing).¹² Others may use virtual currency exchanges, or underground informal value-transfer systems such as hawalas and other similar service providers, popular in South Asia, the Middle East, and in Africa, to move money internationally or concoct trade-based money laundering schemes.¹³ These collaborators then write cheques, exchange virtual currencies or wire the funds to individuals, businesses or shell companies and, through a series of other financial transactions, transfer the funds back to the criminals' accounts in the name of a shell company, with nominee directors and no identified beneficial owner. In other circumstances, cash may be exchanged for casino chips and then used to gamble. Dirty cash can, for example, be inserted into privately owned automated teller machines (ATM) so that credits are transferred electronically to the ATM operator's business and funds transferred to shell companies (Finance Canada 2018; CBC 2013). Co-mingling illegal proceeds with legitimate revenue from cash intensive businesses remains an old and still widely used trick.

With frauds and other crimes, the funds are often in the form of cheques, wire transfers, virtual currencies, bank drafts or are loaded onto credit cards, or appear as loan and mortgage payments made to shell companies or trusts with anonymous beneficial owners. These instruments may tend to raise less suspicion than large cash deposits, yet the

funds to which they are tied can be no less tainted than the cash of drug trafficking.

WHAT IS BENEFICIAL OWNERSHIP OF CORPORATIONS AND TRUSTS? WHAT ARE THE REGULATORY REQUIREMENTS?

In Canada, the most often referred-to definition of beneficial ownership is contained in the *Proceeds of Crime (Money Laundering) and Terrorist Financing* regulations and associated guidelines.¹⁴ It describes a corporation's beneficial owner as the ultimate natural person; e.g., Jane Doe, who owns or controls more than 25 percent of a corporation or any other entity.

The regulations require all financial service providers (FSPs), including banks, credit unions, trust and loan companies, and others, to confirm the existence of any beneficial owner and take reasonable measures to confirm the accuracy of the information obtained about an entity when it opens an account and in other specified circumstances. They also must keep an internal record of the beneficial ownership information. This applies to all FSP customers, whether they are corporations, trusts or other legal arrangements. In this way, FSPs help prevent money laundering and terrorist financing and can better assess the risk of entering a business relationship with an undesirable customer. The obligatory record-keeping requirement also facilitates any criminal investigation.

12 Federal anti-money laundering regulations require reporting entities to report "large cash transactions" when they receive \$10,000 in cash or more or when two or more cash amounts from the same depositor within a 24-hour period total \$10,000 or more.

13 FATF (2013); Asia Pacific Group on Money Laundering (APG) (2013); Financial Action Task Force (FATF) (2016). "Guidance for risk-based approach – Money or Value Transfer Services. February" and Financial Action Task Force (FATF) (2013) "The Role Of Hawala And Other Similar Service Providers In Money Laundering And Terrorist Financing" <http://www.fatf-gafi.org/media/fatf/documents/reports/Role-of-hawala-and-similar-in-ml-tf.pdf>.

14 FINTRAC (2018) Guidance – Know Your Clients – Beneficial Ownership Requirements <http://www.fintrac.gc.ca/guidance-directives/client-clientele/bor-eng.asp>.

In the case of corporations, the regulations require FSPs to obtain the names of all directors and the names and addresses of all persons who own or control, directly or indirectly, 25 percent or more of the corporation's shares. In the case of a trust, FSPs must obtain the names and addresses of all trustees as well as all known beneficiaries and settlors. In the case of an entity other than a corporation or trust, similar requirements apply.

As an alternative procedure, if the FSP is unable to get the required information or to confirm that information, it must take reasonable measures to ascertain the identity of the entity's most senior managing officer. The FSP must also treat the activities of that entity as high risk and take prescribed mitigating measures. Those measures may include monitoring more closely the client's transactions, obtaining senior management approval before concluding a transaction or other procedures.

The regulatory provisions on beneficial ownership do not apply to other reporting entities such as real estate brokers and developers, accountants, B.C. notaries, casinos and dealers in precious metals and stones. In the jargon of the Financial Action Task Force (FATF), the international anti-money laundering standard-setting body, these non-FSP sectors are known as Designated Non-Financial Businesses and Professions (DNFBPs).

WHAT'S THE CONNECTION BETWEEN MONEY LAUNDERING AND BENEFICIAL OWNERSHIP?

There is a clear link between money laundering and hidden beneficial ownership. The abuse of corporate vehicles and camouflaged beneficial ownership is a recognized means of laundering money – and a worldwide problem. For example, the World Bank's review of 150 grand corruption cases (more than

US\$1 million) indicated that companies were used to launder the proceeds in more than 85 percent of cases. In more than half of these cases, corrupt officials used nominees, shell corporations and trusts to disguise their beneficial ownership and the proceeds of their crimes. The World Bank's study showed that the cases:

... shared a number of common characteristics. In the vast majority of them, a corporate vehicle was misused to hide the money trail; the corporate vehicle in question was a company or corporation; the proceeds and instruments of corruption consisted of funds in a bank account; and in cases where the ownership information was available, the corporate vehicle in question was established or managed by a professional intermediary. (The World Bank and UNODC 2011.)

In May 2016, the scope of money laundering raised international public and government concern through the publication of the Panama Papers. The papers contained 11.5 million files of more than 214,488 offshore entities from the database of Mossack Fonseca, the world's fourth largest offshore law firm. The leaked documents were reported on by 107 media organizations in 80 countries and became a turning point in exposing how offshore companies could be abused to hide the beneficial ownership of kleptocrats, tax evaders and money launderers. The link between, on the one hand, criminals, tax evaders and kleptocrats and, on the other, hidden beneficial ownership was evident in many cases including, for example, one involving the Canada Revenue Agency (CRA). Canada's tax authority reportedly executed search warrants during an investigation into potential tax evasion by an Alberta businessman who had been helping Chinese investors to buy oil patch assets. According to a CBC report, court records revealed

that the businessman in question "...is the first person known to be targeted by the CRA's criminal investigations into the Panama Papers."¹⁵

The Panama Papers and their links to Canada followed a review by the Financial Transactions and Reports Analysis Centre of Canada of 40 money laundering court cases (FINTRAC 2015). The study found that the "individuals convicted of money laundering were most commonly identified as entrepreneurs and typically use their businesses to facilitate money laundering." The report also noted that the most frequently used vehicles or financial instruments for money laundering included companies that comingled proceeds of crime or were shell corporations. While the justice system may have been able to achieve money laundering convictions in some of these cases, it wasn't without extensive investigative efforts over many years and high costs to the police and judicial system. Among the toughest challenges was identifying the beneficial ownership of a shell company or trust.

In July 2018, the multilateral Financial Action Task Force released a report linking hidden beneficial ownership to money laundering, noting that, "Analysis of 106 case studies demonstrates that legal persons, principally shell companies, are a key feature in schemes designed to disguise beneficial ownership..." (FATF 2018).

Hiding the beneficial ownership of a corporation or trust is a relatively easy and common means of facilitating money laundering. Obfuscating beneficial ownership has been associated with many "offshore" jurisdictions. However, the role of other locations such as several US states, particularly

Delaware and Nevada, and Canada, has often gone unnoticed.

IS CANADA A LAGGARD WHEN IT COMES TO BENEFICIAL OWNERSHIP TRANSPARENCY AND COMBATTING MONEY LAUNDERING?

Domestic and international studies reveal that Canada is a laggard on beneficial ownership transparency. At the G7 Paris Summit in 1989, Canada helped establish the FATF. Only a year later, the FATF developed a set of international standards for combatting money laundering. But Canada would not act for another 10 years in implementing those international standards. After that long inactive period, the new millennium started off well for Canada. The *Proceeds of Crime (Money Laundering) Act* was introduced in 2000. This was a positive development at a time when critics had been describing Canada as a "black hole" for money laundering.¹⁶ Canada was now catching up with many of its western counterparts but stood out nonetheless as slower by more than a decade compared with the US (1986) and Australia (1988).¹⁷

Continuing from 2001, there have been many welcome revisions to Canadian legislation and regulations helping to better prevent and detect money laundering. As a result, the domestic anti-money laundering and anti-terrorist financing regime has become even stronger. But despite progress in many areas, Canada has yet to reach the FATF's bar on beneficial ownership.

15 CBC News (2018). In response to the unproven allegations, Mr. Yang told CBC News: "I am aware of certain allegations made against me reported in the media today. As a Canadian and a member of the community, I take these allegations very seriously and intend to address them in the fullness of time."

16 Beare and Schneider (2007).

17 The *Proceeds of Crime (Money Laundering) Act* was later modified in 2001 to become the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* after the terrorist attacks of Sept. 11, 2001.

Despite awareness of the gap in meeting international standards and abuse of shell companies and trusts, little has been done to make beneficial ownership more transparent in regulating the formation, registration and ongoing maintenance of corporations. Organized crime, tax evaders and money launderers don't stand still. Their dirty money flows on a path of least resistance to the safest harbour. Canada offers such a refuge with its strong economy and stable financial system. A study surveying more than 3,700 corporate service providers in 182 countries, found that the worst havens for corporate crime were places like Canada where beneficial ownership could be hidden (Séguin 2013; see also Centre for Governance and Public Policy 2012).

At the 2014 Brisbane G20 Summit, Canada committed to tackle corporate secrecy.¹⁸ In agreeing to the G-20 summit's 10 principles to make beneficial ownership information transparent and accessible, Canada was to ensure that all companies and trusts identify their beneficial owners and make that information available to law enforcement and tax authorities. So far, those commitments have not been met except in two cases. Bearer instruments, securities in which no ownership information is recorded and the security is issued in physical form to the purchaser, have been eliminated (shares, warrants and options) from the *Canada Business Corporations Act* at the federal level, but not in the remaining provincial and territorial jurisdictions. The other development has been B.C.'s planned introduction of a publicly accessible beneficial real-estate ownership registry.

In April 2018, Transparency International, an organization at the forefront of global anti-corruption efforts, evaluated progress among 23 nations against those 2014 G20 commitments. Canada stood, with South Korea, as the only two as having a weak beneficial ownership transparency framework.¹⁹ Indeed, substantive progress has not been made by Canada since the previous evaluation in 2015.²⁰

Even the federal government acknowledges the problem. According to its 2015 *Assessment of Inherent Risks of Money Laundering and Terrorist Financing in Canada*, the inherent vulnerability of corporations and trusts to money laundering and terrorist financing is very high due to "... the ability of these entities to be used to conceal beneficial ownership, therefore facilitating the disguise and conversion of illicit proceeds."²¹ Meanwhile, in a 2016 peer review published by the FATF, Canada's adherence to beneficial ownership transparency standards was rated as only partially compliant for legal persons, such as corporations, and non-compliant for legal arrangements, such as trusts.²²

Also in 2016, a Transparency International Canada report made several recommendations pointing to the need for a publicly accessible registry of corporations and trusts.²³ The report also noted the difficulty faced by law enforcement in successfully concluding the investigation of money laundering cases:

The lack of available information on private companies and trusts, and who owns them, is a huge obstacle for law enforcement and tax authorities. The RCMP's success rate in

18 See https://star.worldbank.org/sites/star/files/g20_high-level_principles_beneficial_ownership_transparency.pdf.

19 Transparency International (2018).

20 Transparency International (2015).

21 Finance Canada (2015).

22 FATF (2016). Canada – Mutual Evaluation Report.

23 Transparency International Canada (2016).

pursuing money laundering is a fraction of what it is for other crimes. A suspect cannot be identified in more than 80 percent of cases, and only a third of the cases that go to trial result in a conviction. The cost to the treasury in lost tax revenues is impossible to measure given the lack of data on legal entities and arrangements but is likely in the billions of dollars.

For her part, Ottawa lawyer and international anti-money laundering consultant Mora Johnson, in her analysis of beneficial ownership transparency in Canada, found that:

A number of laws in Canada enable actors involved in business transactions to obscure beneficial ownership, and are out of step with global efforts to address money laundering and terrorism financing. Canada is falling short of global standards on beneficial ownership transparency, including the Financial Action Task Force Recommendations and Canada's commitments at the G20... (Johnson 2017).

Furthermore, the Tax Justice Network's 2018 Financial Secrecy Index ranking of 112 jurisdictions assessed Canada as the 21st worst financial-secrecy jurisdiction.²⁴ Switzerland was ranked the worst with the US second and the Cayman Islands third.

This does not bode well for Canada's financial transparency reputation. Canada is widely seen as a destination of choice for funnelling the proceeds of crimes. In its May 18, 2018 update of 50 countries' effectiveness in meeting Intermediate Outcome

5, which deals with misuse of legal persons and arrangements and the availability of beneficial ownership information to competent authorities, the FATF found Canada had a "low level of effectiveness."²⁵ Canada isn't alone in that category. It shares that dubious honour with 21 other countries, including the US.²⁶

If this delayed state of remedial action on beneficial ownership transparency is an insufficient motive for governments in Canada to implement a public registry of beneficial ownership, a look into the near future should signal a call to action. The EU's Fifth Anti-money Laundering Directive, which came into force on June 19, 2018, compels EU member states to "publicly" disclose beneficial ownership information of companies and trusts owning companies.²⁷ This decision is a major step in strengthening its anti-money laundering and anti-terrorist-financing regime. As a result, information will be accessible to the public, not just to competent authorities.

For its part, Canada is only considering making such information available to relevant authorities. Given Canada's recent implementation of the Comprehensive Economic Trade Agreement with the EU, it would not be a surprise if the EU itself pushes Canada for reciprocity on beneficial ownership transparency to safeguard its own bankers, businesses and investors from money laundering/terrorist-financing risk when conducting due diligence on Canadian companies and trusts.

24 Tax Justice Network (2018).

25 See <http://www.fatf-gafi.org/media/fatf/documents/4th-Round-Ratings.pdf>.

26 Low level of effectiveness means the immediate outcome is not achieved or achieved only to a negligible extent and fundamental improvements are needed. The other countries with a low level of effectiveness are: Bangladesh, Bhutan, Botswana, Cambodia, Costa Rica, Fiji, Ghana, Honduras, Hungary, Iceland, Jamaica, Mongolia, Nicaragua, Panama, Sri Lanka, Thailand, Tunisia, Uganda, Vanuatu and Zimbabwe. G7 members not yet evaluated under the FATF's 2013 methodology are France, Germany, Japan and the United Kingdom.

27 Directive (EU) 2018/843 of the European Parliament and of the Council (2018).

CORPORATE REGISTRIES DO NOT COLLECT BENEFICIAL OWNERSHIP INFORMATION

There are several reasons for Canada's low transparency rankings.

One major concern is nominee directors for shell companies with no apparent legitimate purpose who create corporate veils for faceless beneficial owners.²⁸ Straw directors and administrators have been used to act as nominees for hundreds, if not thousands, of corporate bodies at a time.²⁹ In such circumstances, one has to question the role played by government-run corporate registry offices to verify if these corporations are what they say they are and not just shell corporations.

How are FSPs to know who is hiding behind these ghost corporations when governmental registries don't exercise due diligence when giving birth to legal entities? While the federal government's regulations require reporting entities to conduct due diligence on their customers, the same standards do not apply for identification, verification and monitoring of beneficial owners under the *Canada Business Corporations Act* (CBCA).

Typically, government registries process corporation applications and any subsequent changes to registration information. They monitor for basic obligations such as the filing of annual returns and may penalize for failures to comply. For example, the CBCA provides sanctions for offences such as failure to prepare, maintain and provide access to records as well as failure to prevent the loss or destruction of records, the falsification of entries

or failure to facilitate detection and correction of inaccuracies.

Furthermore, the CBCA, like all other corporate business laws in Canada, the US and most other countries, doesn't require the identification of beneficial owners and allows for nominee directors and shareholders. While the Director appointed under the CBCA by the Minister has the right to apply to a court to order an investigation into a corporation and also has the authority to require information from any person that he or she believes has an interest in a corporation, Corporations Canada does not systematically research the corporate registry database to inquire about the possible criminal background or criminal association of beneficial owners, directors or officers. Corporations Canada also does not ask why someone would be a director or officer running 200 corporations at the same address or the nature of those businesses. Provincial and territorial corporate registrars also do not systematically ensure that the information in their registries is accurate, verified and monitored for possible money laundering or terrorist financing.

There is one exception where beneficial ownership information must be disclosed. Insider trading rules require that beneficial ownership information of securities purchased, held and sold by insiders be disclosed. For publicly traded companies, beneficial ownership information is available on the System for Electronic Disclosure by Insiders (SEDI).³⁰ Through SEDI, owners of 10 percent or more of shares are identified by family and given names, municipality, province, territory or state, country, name of the corporation issuing

28 *Toronto Star* (2017). "Signatures for Sale - Paid to sign corporate documents, nominee directors serve to hide companies' real owners."

29 CBC News (2017).

30 The System for Electronic Disclosure by Insiders (SEDI) is Canada's online, browser-based service for the filing and viewing of insider reports as required by various provincial securities rules and regulations.

the shares, date the insider became an insider of this issuer number, relationship of the insider to the issuers, etc. However, anyone holding less than 10 percent of shares may remain anonymous as an “objecting beneficial owner.”

As noted in Transparency International Canada’s 2016 “No Reason to Hide” report, “...more rigorous identity checks are done for individuals getting library cards than for those setting up companies.” When people are born, sufficient scrutiny is exercised to identify their name; place, time and date of birth; and their parents’ names, etc. When a library card is issued, municipalities generally require photo identification, proof of address, email address and telephone number. When individuals acquire vehicles, they provide such personal information to the vehicle registration office. Individuals, as natural persons, are required to provide personal information when opening a bank account, opening a business as a sole proprietorship, buying a house and registering property with the land registry office, investing in securities or engaging in other financial transactions. Yet when a corporation is created in Canada, there is no requirement to identify and verify the identity of the ultimate person(s) who controls or owns the corporation.

The UK in 2016 became the first country to implement a publicly accessible registry of beneficial owners. The registry is a two-tiered system. Law enforcement officials can learn personal information such as date of birth and usual residential address while the public, electronically and free of charge, can learn the name, month and year of birth, the nationality, the country of residence and the correspondence address of the person who has significant influence or control over the company. In short, the UK’s registry provides

sufficient publicly accessible information to meet transparency requirements.³¹

WHAT’S WRONG WITH CANADA’S BENEFICIAL OWNERSHIP REQUIREMENTS?

Canada’s current beneficial ownership requirements have four significant weaknesses.

First, the regulations put the onus on FSPs to obtain beneficial ownership information, as opposed to requiring corporations and trusts to actively disclose the information as a prerequisite to opening an account or conducting a financial transaction. Furthermore, FSPs must comply without a registry. For the most part, they rely on customers for the required information. However, the information is not always available, and there’s no guarantee that the information provided by the customer is complete and accurate.

Second, while the regulations stipulate alternative procedures if entities are unable to obtain beneficial ownership information, or are unable to confirm its accuracy, these procedures also do not guarantee the identification of the beneficial owner or the accuracy of the information. Under these alternative risk-mitigating procedures, entities must:

- take reasonable measures to verify the identity of the entity’s most senior managing officer (e.g., for a trust, the senior managing officer is the trustee);
- treat the entity’s transactions and activities as high-risk; and
- apply “enhanced” measures for high-risk clients, including stepped up ongoing monitoring.

Enhanced measures may also include additional checks such as:³²

- obtaining information on the client’s source of

31 Government of UK - Companies House.

32 FINTRAC (2017). Ongoing monitoring requirements.

funds, source of wealth or on the reasons for intended or conducted transactions;

- increased monitoring of transactions of higher-risk products, services and channels;
- gathering additional documents, data or information, or taking additional steps to verify the documents obtained;
- establishing transaction limits;
- increasing internal controls of high-risk business relationships; and
- obtaining senior management approval for new products and services.

Consequently, FSPs incur costs to determine the customer's beneficial ownership and take increased financial and reputational risks when the beneficial owner cannot be ultimately identified. These alternative procedures only allow FSPs to satisfy their regulatory requirements, but they do little to effectively identify the beneficial owner.³³ This is especially risky when dealing with customers that are privately held corporations, owned by other corporations or trusts in concocted complex structures.

Third, the FATF standard recommends that countries should ensure that both FSPs and DNFBPs obtain beneficial ownership information. However, Canadian regulations exempt DNFBPs from this requirement. Not only is Canada offside with international standards in this regard, but the result is that DNFBPs, such as real estate, are among the most highly vulnerable sectors for money laundering and are off the hook for identifying beneficial owners. That's a critical gap when one considers the many reports of suspicious transactions in hot real estate markets such as

Vancouver where, in a December 2016 report by Transparency International Canada, it was found:

... that nearly half of the 100 most valuable residential properties in Greater Vancouver are held through structures that hide their beneficial owners. Nearly one-third of the properties are owned through shell companies, while at least 11 percent have a nominee listed on title. The use of nominees appears to be on the rise; more than a quarter of the high-end homes bought in the last five years are owned by students or homemakers with no clear source of income. Trusts are also common ownership structures for luxury properties; titles for six of the 100 properties disclose that they are held through trusts, but the actual number may be much higher as there is no need to register a trust's existence.

Following reports by Kathy Tomlinson and Xiao Xu of *The Globe and Mail* and Sam Cooper of the *Vancouver Sun*,³⁴ this problem was recognized by the BC government in its 2018 budget that promised a publicly accessible registry that will identify the beneficial owners of real estate (B.C. Budget 2018).³⁵ Knowing that the vulnerability to money laundering is high in the real estate sector, it is alarming that other governments, especially in the Greater Toronto Area, have remained passive about identifying the ultimate beneficial owners of corporations and trusts involved in real estate transactions.

Fourth, in comparison to corporations and trusts, individuals are treated with greater scrutiny under the regulations. The identification required to incorporate a business is usually satisfied by the

33 Or in the case of trusts, the settlors, trustees and beneficiaries.

34 See *The Globe and Mail*. 2018. "B.C. vows crackdown after Globe investigation reveals money-laundering scheme." By Kathy Tomlinson and Xiao Xu. February 16, and *Vancouver Sun*. 2017. "Exclusive: How B.C. casinos are used to launder millions in drug cash." By Sam Cooper. September 29.

35 In June 2018, the BC Ministry of Finance published a "*Land Owner Transparency Act* White Paper: Draft Legislation with Annotations" that, if approved, will follow through on the government's commitment.

disclosure of such information as the name of the directors and majority shareholder, which can be another corporation, the registered office address, the name of the corporation, the business number, with the possibility that any of the named persons may be nominees. As mentioned previously, when individuals open an account with a reporting entity, whether a FSP or a DNFBP, they must not only supply their name and address but also the date of birth and disclose the nature of their principal business or occupation.

In most instances, applicants must provide a government approved photo identification to obtain a bank account, library card or official documents such as a passport and driver's licence. No such scrutiny is placed on the beneficial owners of corporations or parties to a trust. This would appear to offer greater privacy rights to corporations and trusts than individuals. By creating a corporation, trust or other legal arrangement as an opaque wall between beneficial owners and the regulators, beneficial owners are given licence to operate anonymously in the shadows. Trusts and corporations, especially privately owned businesses, are afforded the opportunity to hide the type of information required of natural persons transacting on their own behalf.

RECOMMENDATIONS FOR A NATIONAL PUBLICLY ACCESSIBLE REGISTRY OF BENEFICIAL OWNERSHIP

This *Commentary's* overriding recommendation is for the federal government, in collaboration with the provinces and territories, to establish a central publicly accessible beneficial ownership registry of corporations and certain trusts.

Combatting money laundering, tax evasion, corruption and terrorist financing raises serious challenges. Prevention, detection and action are the keys to safeguarding against threats. Law enforcement agencies are swamped with cases, from

the mundane to the complex. They alone cannot combat complex financial crime. All reporting entities, all businesses and government licensing and procurement offices can play a part and need to know who they are dealing with to minimize and prevent their organizations from being abused by financial crime. A publicly accessible registry would allow these organizations, the media, the public and civil society to play a part in keeping in check ill-intended individuals who attempt to conceal their ownership and control of corporations and trusts. The Panama Papers and subsequent revelations clearly showed that public disclosure and transparency sheds light on the corrupt and those who threaten public safety.

On the compliance continuum, from crime prevention through detection, investigation, prosecution, asset seizure and forfeiture, costs increase, and successful conviction and asset recovery are never assured. A public registry, as a tool to assist in preventing and deterring non-compliance at its earliest stage, would be an effective risk-reduction strategy. At every point on the continuum, collaboration is needed among legislators, policymakers, the private sector, regulators, law enforcement, the judiciary, civil society organizations, the media and the public. There is no one solution to eliminating money laundering but it is folly to think that law enforcement alone can prevent, detect and deter financial crimes.

That said, four important steps should be taken to implement a publicly accessible beneficial ownership registry of corporations and certain trusts.

First: Reform Corporate Registries

When registering a corporation, registrars should be required to verify the identity of the beneficial owner with government-approved identification and require a sworn statement or attestation of beneficial ownership. If a corporate registry is to be useful for FSPs, law enforcement, suppliers,

creditors and others, getting accurate and reliable information about the beneficial owners at the outset is fundamental.³⁶

Governments must also re-examine the use of nominees. Nominees should be compelled to disclose their status, their nominator and the beneficial owner. The use of options in acquiring beneficial ownership must also be disclosed. Furthermore, government-established corporate registrars need the mandate and resources to audit, require information and monitor corporations for unusual and suspicious activity and apply proportionate and dissuasive sanctions when directors are in contravention of their obligations. This active approach would be a sea change to the current mostly passive stance across Canada.

Clearly, corporate registries must obtain and make beneficial ownership information publicly accessible throughout the life cycle of the corporation. Administrative monetary penalties should be hefty with criminal offences attached to any serious breach of obligations.

The registry data should be harmonized among jurisdictions and structured to allow one-stop search capability.³⁷ The challenge represented by this harmonization is significant given the 14 Canadian jurisdictions involved. However, the EU, with its 28 member states, has made considerable progress in addressing this similar challenge. In fact, the EU requires an interconnection of all member-state registries to a central electronic platform.³⁸

No analysis has been undertaken to estimate the cost and effort of adopting such an activist approach. However, whatever the drawbacks, they are trumped by how access to reliable information about beneficial owners helps businesses and governments prevent and deter illicit money flows. If implemented, a public registry would begin turning around Canada's reputation as a financially secretive jurisdiction.

Second: Place the Onus on Corporations and Trusts to Disclose Beneficial Ownership

Until corporate and trust registries provide accurate beneficial ownership information in a publicly accessible format, the onus should be on corporations and trusts to provide it to FSPs. If there is no accessible and accurate verified beneficial information, based on government-approved identification, then accounts should not be opened and financial transactions should not be conducted.

The playing field for all businesses would be levelled with the responsibility placed squarely on the corporation or trust to divulge the ultimate beneficial owner or, in the case of trusts, the settlor(s), the trustee, the beneficiaries and the protector (if any). As a result, the alternative procedure for identification of beneficial ownership would be eliminated, ensuring that only the beneficial owners' information is obtained and not that of a nominee fronting as a senior managing partner.

36 Limited research has not uncovered other jurisdictions that require government-issued ID when creating a corporation, except for a bill now being debated in the US Congress. However, the beneficial ownership provisions were recently removed from the bill.

37 The lack of harmonization of corporate registration requirements among jurisdictions has been aptly described by Daniel Schwanen and Omar Chatur in their 2014 C. D. Howe Institute E-Brief.

38 See paragraph 53 of the EU's Anti-money Laundering Directive 5 at <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018L0843&from=EN>.

Third: Require Designated Non-Financial Businesses and Professions to Identify Beneficial Owners

All DNFBPs should be required to obtain beneficial ownership information once access to publicly accessible beneficial ownership registries is implemented. This will ensure that all reporting entities are more effectively managing risks for money laundering and terrorist financing at minimum cost. It would also ensure compliance with FATF standards on beneficial ownership.

Fourth: If You Won't Lead, Then At Least Follow the Pack

Instead of looking to meet the 2012 FATF beneficial ownership standard, Canada should be proactive, strategic and strive to meet the new EU standard by creating a central publicly accessible beneficial ownership registry. Already, some countries such as Norway, Denmark, Ukraine and the UK have implemented public registries of beneficial ownership. By early 2020, all 28 European Union member states and a majority of FATF's 37 members will be on track to implement publicly accessible registries of beneficial ownership.

In addition, even non-EU members such as Liechtenstein, Iceland and Norway, as members of the European Economic Area, must follow the EU's lead. On May 1, 2018, the UK Parliament voted to require the UK's 14 overseas territories to publish public registers of company ownership by the end of 2020. Ghana, Indonesia and South Africa have also made similar commitments. More than 40 countries now have, or are committed to having, public registries.

Given this momentum toward a global standard for a publicly accessible beneficial ownership registry, what should Canada do? Federal, provincial

and territorial governments need to work together and heed Wayne Gretzky's advice: "Skate to where the puck is going, not where it has been." Canada needs to read the tea leaves and join the global movement toward publicly accessible registries.

PRIVACY CONSIDERATIONS

Concerns have been expressed about potential identity theft and other crimes that could be perpetrated against beneficial owners identified in a public registry. While privacy is important, it must be weighed against public safety. Already, disclosure of beneficial ownership in Canada is a fact for shareholders holding 10 percent or more of a corporation's voting rights. If such disclosure had breached privacy protections under the Canadian Charter of Rights and Freedoms, then that disclosure likely would have been successfully challenged in the courts. Since it hasn't, why should this be a concern for all beneficial owners?

Article 8 of the European Convention on Human Rights is clear about the subordination of privacy rights to "...interests of national security, public safety or the economic well-being of the country, for the prevention of disorder or crime, for the protection of health or morals, or for the protection of the rights and freedoms of others" (European Court of Human Rights 2002). Nevertheless, a reformed corporate Canadian registry system could mitigate concerns about lack of privacy by considering exemptions. The UK registry allows for such exemptions when there is evidence of serious risk of violence or intimidation to the "person exercising significant control" (UK Government 2017). BC's proposed *Land Owner Transparency Act* also contains provisions that consider exemptions to the disclosure of beneficial ownership in certain circumstances.³⁹

39 See Article 83 of the *proposed BC Land Owner Transparency Act* at <http://www.fin.gov.bc.ca/pld/fcsp/LOTA-white-paper-june-2018.pdf>.

CONCLUSION: DESIGNING A PUBLICLY ACCESSIBLE BENEFICIAL OWNERSHIP REGISTRY

In testimony before the House of Commons Standing Committee on Finance in the spring of 2018, a diverse set of witnesses supported the implementation of a publicly accessible beneficial ownership registry.⁴⁰ They noted positives such as reducing the complexity in identifying ownership structure, minimizing compliance costs, ensuring consistent information among institutions about the same customer and better risk assessment.

What characteristics would make up a central publicly accessible registry? The ability to reliably pinpoint the beneficial ownership of a corporation or trust is paramount. That could include a uniquely assigned identifier, name, correspondence address, country of residence for tax purposes, citizenship, month and year of birth, and nature and extent of the beneficial interest held. These data elements are consistent with those that will be made available to EU citizens.⁴¹ The less information that is provided publicly without sacrificing reliability in identifying the beneficial owner, the better it will be for minimizing privacy concerns.

To achieve reliability, prompt registry updates would be required. Ideally, the registry information would be centralized, free, designed in an open data format with searchable fields. This would level the playing field for businesses and governments in assessing financial and reputational risks. In weighing privacy against the public interest, public interest is an overarching priority. This author concurs with Finance Minister Bill Morneau's statement on June 20, 2018 that: "To put it bluntly, these things [money laundering and terrorist financing] are a threat to the safety and security of Canadians and the government knows that keeping Canadians safe has to be a top priority ..."⁴²

The pace of change on beneficial ownership transparency in Canada has been glacial over the past 15 years. In an evolving environment for greater public safety, Canada is not leading the pack, or even following. If Canada is to be back on the international scene, showtime is now.

40 They included the Canadian Credit Union Association, the Investment Industry Association of Canada, Transparency International Canada and the Federation of Law Societies of Canada.

41 See paragraph 14 (c) of the European Parliament's Directive (EU) 2018/843 that references an amendment to Article 30 providing for public disclosure of " ...the name, the month and year of birth and the country of residence and nationality of the beneficial owner, as well as the nature and extent of the beneficial interest held."

42 See [http://parlvu.parl.gc.ca/XRender/en/PowerBrowser/PowerBrowserV2/20180620/-1/29632?Language=English&Stream=Video&useragent=Mozilla/5.0%20\(Windows%20NT%2010.0;%20Win64;%20x64\)%20AppleWebKit/537.36%20\(KHTML,%20like%20Gecko\)%20Chrome/67.0.3396.87%20Safari/537.36](http://parlvu.parl.gc.ca/XRender/en/PowerBrowser/PowerBrowserV2/20180620/-1/29632?Language=English&Stream=Video&useragent=Mozilla/5.0%20(Windows%20NT%2010.0;%20Win64;%20x64)%20AppleWebKit/537.36%20(KHTML,%20like%20Gecko)%20Chrome/67.0.3396.87%20Safari/537.36) at 12:52:50.

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