



Anti-money laundering and terrorist financing in Canada

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A pervasive global challenge

Despite massive investments in mitigation capabilities, financial crime remains a trillion-dollar global issue with impacts that extend well beyond the financial services industry. Crimes such as money laundering and terrorist financing harm broader society in many ways, in Canada and around the world. Through a complex web of funds, financial crime allows criminals to profit from illegal activity, gives terrorists the financial means to cause harm, and deprives governments of tax revenues that are required to address social needs. It is a broad issue and requires urgent attention from nation states and financial institutions alike, especially as evolving geopolitical dynamics (such as Russia's recent invasion of Ukraine), and the lack of globally aligned solutions create new pathways for illicit financial flows.

In a recent global report co-authored by Deloitte and the Institute of International Finance (IIF) – entitled *A Way Forward on Continuing to Enhance Effectiveness in Financial Crime Risk Management* – we explored a framework for public and private sector stakeholders to continue to enhance the effectiveness of their anti-financial crime strategies.

In this report, we apply a distinctly Canadian lens to understand the challenges faced by our domestic stakeholders, and revisit the framework in the Canadian context.



Growing vulnerabilities in Canada

Under the cover of increasingly sophisticated disguises, financial criminals continue to do business through the Canadian financial system.¹ Directly and indirectly, this drives multiple negative societal outcomes, such as unaffordable housing (because a meaningful portion of the proceeds of illicit financial activity is held in real estate, which ultimately pushes up housing prices), expanded criminal activity related to the drug trade and human trafficking, increased corruption, and the growth of political and religious extremism.

Without comprehensive, coordinated preventative measures, Canada will continue to be vulnerable to new and unexpected issues related to financial crime. Take, for example, the recent so-called “freedom convoy” occupation in Ottawa. Without a robust framework to deal with such a challenge, the Government of Canada was forced to issue an emergency order that required banks to immediately freeze accounts connected to individuals suspected to have been involved in illegal activity. Alternatively, consider the steady increase in cryptocurrency popularity in Canada. Flows in these and other digital assets are difficult to trace and often intentionally obscured. This makes it extremely challenging to clamp down on illegal activity financed via this medium.

Financial crime is a long-standing issue for Canada, but there have been numerous regulatory efforts in recent years that have attempted to strengthen oversight and private-sector accountability. For example, a recent call to action from Prime Minister Justin Trudeau included a directive to accelerate the work to establish a dedicated unit to investigate all forms of major financial crime and consider options for strengthening regulations and the investigative powers of regulators.

Meanwhile, key agencies, including the Financial Transactions and Reports Analysis Centre (FINTRAC), continue to make strides in refining legislative frameworks and sharing financial intelligence. However, Canada still has much to do to ensure sound economic and social resiliency in the face of financial crime threats.

The federal government has committed to establishing Canada’s first national agency whose sole purpose is to investigate these highly complex crimes and enforce federal law. Coupled with an investment of \$200 million over the next four years and new powers, this agency will bring the existing law enforcement resources of the RCMP, the intelligence capabilities of FINTRAC, and the expertise of the Canada Revenue Agency together under one roof.



Mounting scrutiny and new commitments

While difficult to track globally, it is estimated that less than 1% of transactions flagged for potential links to financial crime are addressed by authorities, despite continuous investment in anti-money laundering and terrorist financing (AMLTF) detection and prevention mechanisms. Gauging the amount of money laundered in Canada has also been proven difficult, but a Government of British Columbia report published estimated the figure to be a considerable \$46.7B in 2018.² Facing mounting public scrutiny of money laundering, governments have begun to act. For example, the BC Provincial Government established the Cullen Commission to investigate

and make recommendations to address the issue. Set for release in May 2022, a report on the commission's findings is expected to link the flow of hundreds of millions of dollars in illegal cash to organized crime, directly affecting the real estate, luxury vehicle, and gaming sectors, among others.³

When considering the many ways in which the crimes of money laundering and terrorist financing might evolve in Canada, several discrete examples emerge that demonstrate how difficult it can be to track and prevent high-volume activity:



Charities and fundraisers are at risk of being used to finance terrorism, given that many of the financial

transactions conducted by registered charities occur in channels that provide a high degree of anonymity to contributors and have limited regulatory oversight, despite being registered with FINTRAC.

Case study: *Financial support for the Ottawa occupation in February 2022 was facilitated through a fundraiser for "Freedom Convoy 2022" hosted on a popular crowdfunding website.*



The cannabis industry is more readily exploited for money laundering, undermining the

public-policy goal of creating a legalized market.⁴ Contributing factors include the preference of cannabis retail customers to use cash or hard-to-trace cryptocurrencies as a method of payment, concerns around privacy, and the risks associated with the supply of cannabis from illegal sources.

Case study: *FINTRAC has acknowledged the issue of money laundering in connection to the legalization of recreational marijuana and pledged to take a preliminary look at the matter.*



Billions of dollars in laundered money has made its way into Canadian real estate transactions,

and international money laundering watchdogs are concerned with Canada's challenges in regulating mortgage brokers, lenders, housing investment funds, realtors, developers, and lawyers.⁵

Case study: *A 2019 RCMP study found that about half the money laundered through Canadian real estate came from outside the country, with China accounting for nearly a quarter of the foreign funds. Of the domestic money laundered through real estate, well over half came from drug trafficking.*



Unclear returns on to-date investment

Despite broad industry consensus on taking more action and the considerable amounts spent to address financial crime, Canada has yet to realize a good return on investment in terms of significantly reducing the actual flow of illicit transactions. Financial institutions are making large investments in resources and systems for compliance programs, with an estimated average annual spend in the multiple million dollar range.

However, while technically adhering to minimum regulatory requirements, current processes are often plagued by the inefficiencies of legacy systems and trail behind criminals' sophisticated and evolving methods of avoiding detection. While privacy considerations have informed the design of the financial intelligence life cycle, it is inherently difficult to coordinate efforts and achieve efficient outcomes for increasingly complex money laundering schemes.

The key challenges include:

Data integration

Limitations in the integration and sharing of relevant data between sources of intelligence disproportionately affect key AMLTF functions, including transaction monitoring, risk-rating models, and compliance reporting. Keeping pace with the rate of criminal exploitation will continue to challenge reporting entities if actionable insights are not captured and delivered to public and private sector actors in near-real time. Looking beyond transaction traceability, the type of data being analyzed by most financial institutions lacks the necessary context to properly conduct investigations. Behavioral characteristics, for example, are rarely monitored to spot suspicious patterns.

Data quality

Beyond efficient intelligence-sharing, the quality and depth of the data being shared is critical to gathering actionable insights and achieving quick legal resolutions. Thousands of high-volume, low-quality suspicious transaction reports are routinely generated by financial institutions and left to public agencies to address, often hindering early detection and effective prosecution. For example, consumer and transactional data is segregated when disseminated from various reporting entities, which makes it difficult for agencies such as FINTRAC to act on complete information.

Manual processes

Although many organizations have launched digital transformation efforts, most still rely on manual tasks in their AMLTF processes. Administrative tasks and manual data collection are not the only lagging mechanisms either. Many financial institutions still depend on manual screening and interventions when the situation calls for real-time decisions enabled by capabilities such as artificial intelligence (AI), deep learning, and natural language processing. This leaves them unnecessarily exposed to human error, substantial resource costs, and the risk of regulatory fines and reputational damage.

Compliance culture

Some financial institutions operate as second movers when it comes to getting ahead of regulatory reform and investing in effective anti-financial crime activities. The "compliance culture" exhibited by some organizations, coupled with the regulatory supervisory approach that focuses on achieving minimum regulatory requirements, prevents sound coverage across the entire AMLTF regime. Those that lack risk-focused leaders with strategic ambitions are vulnerable to the exploitation of legacy AMLTF functions. This exposes the financial intelligence life cycle, as it can only be as strong as its weakest link.

Collective, outcome-based solutions

There are six principal areas that demand collective focus to address the challenges brought on by financial crime. All of them require the formation of new partnerships, the evolution of current-state operating models, or the adoption of emerging technologies as part of the solution. The six areas are:

1. Deepening public-private sector partnerships

Unsurprisingly, a network can generally detect and neutralize threats more effectively than individual actors. In Canada, there is a substantial opportunity to create multilateral agreements across our tiered regulatory structure to consolidate fragmented mitigation efforts and cultivate safer data portability. Canadian financial institutions can potentially overcome the challenges associated with costly and siloed information-gathering through increased voluntary data-sharing, and even extend that sharing to global policy bodies and other peer nation states. To facilitate this, regulators and policy bodies should incentivize, accommodate, and encourage the private sector to do so via accommodative policy and regulation.

2. Instilling technology to drive actionable intelligence

For financial institutions to improve their ability to assess transactions and deploy AI-driven capabilities, their infrastructure and technology stack need to be more dynamic and interoperable. This often requires data to be re-platformed from legacy systems to flexible solutions such as the cloud to improve accessibility. New vendors can also support methods for integrating and unlocking novel sources of data, while safeguarding against the misuse of data or leaks into the public domain.

Furthermore, emerging solutions such as blockchain and privacy enhancing technologies (PETs) present unique technical opportunities for secure, privacy-preserving data-sharing. For example, some organizations are exploring homomorphic encryption techniques (which allow mathematical operations to be performed on encrypted data) to share insights about sensitive data such as suspected fraudulent transactions) without sharing the underlying customer data. However, this new form of data-sharing requires the explicit backing of legal frameworks to promote adoption.

3. Shifting to an enforcement mindset

Regulators should explore moving from a primarily compliance and reporting focus to an interdiction and enforcement mindset. But shifting key legislative frameworks will take time. In the interim period, before more accommodative privacy laws that would promote greater public-private partnership on enforcement activities are enacted, financial institutions can focus on proactively investigating reported leads and stopping the movement of illicit money before it arrives at its destination. While cutting-edge technology capabilities are helpful, refinements to the due diligence approach that aim to create a complete financial picture of each client of the financial institution can create more meaningful insights for public agencies.

4. Targeting the right investments to do more

There is a need for ongoing and increased investment tailored to driving both improved outcomes and greater efficiency, rather than patching broken processes. This includes applying special consideration to data quality and access, systems, processes and organizational structure, and available technologies. When allocating investment pools for shared services, for example, organizations need to evaluate the cost-benefit trade-offs of deploying technology at every step of the AMLTF process, from data collection and verification to client data management, transaction monitoring, investigations, and reporting.⁶

5. Revitalizing governance and accountability

Beyond having clear leadership, ownership, and authority over coordinating anti-financial crime efforts, financial institutions need to ensure that their governance models are anchored on intent, competence, and tangible outcomes. Sound governance in the AMLTF operating model means that teams with cross-organizational knowledge are empowered to streamline existing processes and responsibilities. Agile team structures that incentivize proactive research, investigation, and innovation in day-to-day tasks will be able to scale and keep pace with the evolving financial crime landscape.

6. Building efficient intermediaries

Industry and cross-sectoral operating models, including utilities, can unlock the speed and agility needed to detect and prevent illicit finance. Steps toward secure data portability could lead to the formation of a shared database for illicit transactions, allowing for easy traceability of bad actors. A successful example of this can be found in the Netherlands, where five Dutch banks established a monitoring body that collates and assesses bank transaction data to find meaningful insights.⁷



A call to action

Recent events in Canada and around the world underscore the need for action in the public and private sectors. Both federal and provincial governments are increasingly frustrated with the lack of progress in jointly tackling financial crime, but they are also becoming more willing to invest at a higher level.

However, it will take integrated leadership with a wide range of participants and a higher sense of urgency to drive the necessary change. Deloitte, for one, intends to soon launch a series of forums for leaders to discuss the way forward.

We encourage all interested parties to act, and help put Canada at the forefront of financial crime prevention.



Endnotes

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