

# **MONEY LAUNDERING THROUGH SECURITIES AN ANALYSIS OF CANADIAN POLICE CASES**

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**O**VER THE LAST 100 YEARS, ORGANIZED criminality has evolved from primitive, neighbourhood-based bands of petty criminals into financially-shrewd and technologically-astute multi-national conglomerates and networks. By the 1990s, a number of trends in the world of organized crime could be discerned, including a proliferation in the number of organized crime “genres” and groups, an increased sophistication and internationalization, a return to predatory crimes (epitomized by the mercurial rise in fraud schemes), a greater fluidity regarding participants and criminal activities, the dismantling of ethnic and racial barriers between conspirators, and a greater cooperation between criminal groups. An analysis of the history of organized crime in the Twentieth Century reveals an almost indefatigable capacity for adaptation and resilience. Enforcement successes are inevitably followed by diminishing returns as organized criminal entrepreneurs become more adaptive and sophisticated. Nothing better exemplifies the growing sophistication of organized crime than its infiltration of capital markets, which evolved from the physical theft of security certificates in the 1950s to technology-assisted fraud and money laundering in the 1990s and beyond. At the same time, police cases clearly show that criminal groups continue to rely on such timeless tactical imperatives as intimidation, violence, and corruption to advance their interests in the securities market. Organized crime has infiltrated the capital markets for two reasons: The first is to make money, primarily through fraud, share manipulation, insider trading, as well as deceitful and coercive telemarketing; the second reason is to launder money, generated from drug trafficking and other profit-oriented crimes.

From the 1950s to the early 1970s, traditional crime groups in the United States and Canada masterminded schemes to steal millions of dollars worth of securities certificates from the vaults of brokerage houses and banks.<sup>1</sup> To help perpetrate these thefts, criminal groups

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<sup>1</sup> Phillips, Alan. 1963b. “The Inner Workings of the Crime Cartel.” *MacLean’s Magazine*.p. 72, October 5.; Walter, R. 1971. “Organized Crime.” *Canadian Securities Magazine*. May: 1-6; Edwards, Peter. 1990. *Blood Brothers: How Canada’s Most Powerful Mafia Family Runs Its Business*. Toronto: Key Porter Books, p. 39.

relied on corruption and intimidation of industry insiders. During the 1950s, the Papalia crime family of Hamilton, Ontario used intimidation tactics to extort money and insider information from securities brokers.<sup>2</sup> From then on, the markets became increasingly vulnerable to manipulation and fraud by criminal groups. In the 1960s and 1970s, William Obront, the financial brains behind Montreal's once-powerful Cotroni mafia family, was charged with over 400 counts of fraudulently manipulating stock market shares over a 15-year period.<sup>3</sup> A 1977 report of the Quebec Police Commission examining organized crime in the private sector dedicated an entire chapter to the securities industry. A 1974 intelligence report on commercial crime by the Coordinated Law Enforcement Unit (CLEU) of British Columbia documented the involvement of organized (and unorganized) criminals in the Vancouver Stock Exchange. According to the report:

Associates of organized crime syndicates from the East have attempted to engage in activity in the Vancouver market. In addition, a number of known local criminals, including drug figures and gambling promoters, are or have been, involved in the market. It has been estimated that there are about 25 to 50 people with criminal records involved in some way or another. The Securities Commission knows of people with long criminal records who associate with major criminally-oriented promoters.<sup>4</sup>

In 1997, police began investigating the possible role of outlaw motorcycle gang members in manipulating the publicly-traded stock of Montreal-based BioChem Pharma. This investigation was intensified after four bombs exploded outside the company's Quebec headquarters on November 24<sup>th</sup> and 25<sup>th</sup> of that year.<sup>5</sup> One media article reported that over those two days, an unusually large number of BioChem "put options" were purchased through the Montreal Exchange. The intent of the bombings may have been to destabilize the stock, causing it to drop

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<sup>2</sup> Phillips, Alan. 1963 "Organized Crime's Grip on Ontario." *MacLean's Magazine*. September 21, p.58.

<sup>3</sup> Quebec Police Commission Inquiry on Organized Crime. 1977. *Organized Crime and the World of Business*. Montreal: Government of Quebec, p.148.

<sup>4</sup> British Columbia. Coordinated Law Enforcement Unit. 1974. *Initial Report on Organized Crime in British Columbia*. Victoria, B.C.: Coordinated Law Enforcement Unit, Ministry of the Attorney-General, p.27.

<sup>5</sup> *Financial Post*. November 28, 1997. "Caller says BioChem animal rights target, but expert suggests Tuesday's bombings were too sophisticated for Animal Liberation Front." p. 4.

rapidly and allowing speculators to make a substantial profit. In April of that year, Claude Duboc, who was arrested and convicted in Florida for his part in orchestrating one of the world's largest hashish trafficking empires, agreed to pay his lawyer F. Lee Bailey, in BioChem stock which was then worth \$5.8 million. Soon after making the transfer, the stock shot up in value to over \$20 million. When U.S. authorities tried to claim the stock as the proceeds of crime, Bailey refused to give it up. He relented only after a judge jailed him for contempt.<sup>6</sup>

By the late-1990s, U.S. federal law enforcement agencies and securities regulators began investigations into allegations that members of Italian-American crime families, in cooperation with Russian crime groups, had established a network of stock promoters, securities dealers, brokerage firms, and "boiler rooms" that sold stocks nationwide through high-pressure sales tactics and intimidation. A 1996 *Business Week* reported that Philip Abramo, a ranking member in the New Jersey-based DeCavalcante crime family, controlled at least four brokerage firms through front men and exerted influence on other investment dealers. Other securities dealers and traders were reported to have paid extortion money or "tribute" to Abramo.<sup>7</sup> Four years after this article was published, federal prosecutors brought indictments against 85 people, including brokers and suspected members and associates of the DeCavalcante organization as well as New York's Colombo, Bonanno, and Genovese crime families. The indictments alleged that the defendants stole more than \$100 million from investors using threats, bribes, pension fund raids, and "pump and dump" market manipulation tactics. It was later shown in court that the conspirators were secretly controlling large blocks of shares in approximately twenty micro-cap companies which they pushed onto investors through high-pressure sales calls. They also paid their own brokers hefty kickbacks to pressure outside investors to buy shares at inflated prices. Mafia enforcers were employed to ensure the brokers would not sell on behalf of their clients, thereby keeping the price of the stocks artificially high. Once the stock value reached its zenith, the conspirators sold their secretly held shares.<sup>8</sup>

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<sup>6</sup> *Vancouver Sun*. April 27, 1997. "B.C. bust ended one of world's biggest drug empires." p. A1.

<sup>7</sup> *Business Week*. December 16, 1996. "The mob on Wall Street."

<sup>8</sup> *Knight Ridder/Tribune Business News*. June 17, 1999. "Five charged with stock fraud in Tampa, Fla."; *The Globe and Mail*. June 17, 1999. "85 Brokers Busted in Stock Fraud Scandal."; *Dow Jones News Service*. July 2, 1999. "Reputed mob associates among indicted."; *Associated Press*. March 2, 2000. "Mob said to infiltrate Wall Street."

As part of his court testimony, Vincent (“Vinnie Ocean”) Palermo, a self-proclaimed murderer and former acting boss of the New Jersey DeCavalcante family, confessed how Philip Abramo was “always bragging about how much money he made on Wall Street, saying he was the best in the business”.<sup>9</sup> Abramo’s market manipulation activities were not confined to the United States. Stockbroker Jean Claude Hauchecorne, who worked at the Vancouver-based Pacific International Securities until 1999, told police that Abramo and two other another mafia-connected figures placed dozens of orders to buy and sell U.S. stocks, many of which had been identified by *Business Week* as mob-manipulated. At one point, Abramo demanded that Hauchecorne return \$1.75 million he had transferred to Switzerland on the instructions of another Mafia operative, with whom Abramo had had a falling out. If he did not heed their demands, they threatened to have him killed.<sup>10</sup>

Organized crime is also interested in the capital markets to launder the profits of other criminal activities, particularly drug trafficking. The goal of this article is to examine how the proceeds from profit-oriented (organized) criminal activities in Canada and abroad are disbursed through the securities market. The objectives of the study upon which this article is based, were to identify, examine, and quantify the types of illegal activity that generate the criminal revenue invested into the legitimate economy, the sectors of the economy into which criminal proceeds are placed, specific assets or services used within the respective sectors, transactions and processes used for money laundering purposes, and specific guises and/or techniques employed to facilitate the money laundering process at deposit institutions.

This paper begins with a description of the research design that informs this paper, followed by the presentation of data and case studies that explore money laundering in the securities market. This paper concludes by discussing the threats posed to the securities markets by criminal organizations, as well as the current and future enforcement measures necessary to combat this problem.

### **Research Design**

The findings and analysis summarized in this article have been taken from a national study on money laundering in Canada that was conducted between 2000 and 2003.<sup>11</sup> For the purposes of this paper, the

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<sup>9</sup> *Sunday Times* [London]. May 18 2003. “The mafia on Wall Street.”

<sup>10</sup> *Canadian Business*. November 15, 2002. “Troubled waters: Pacific International is under the microscope of the BC Securities Commission, which alleges some of its officers and directors turned a blind eye to mob-related transactions.”

<sup>11</sup> Schneider, Stephen. 2004. *Money Laundering In Canada: An Analysis of RCMP*

primary data is complemented with the results of a similar study published in 1990<sup>12</sup>, as well as secondary information extracted from government reports, the media, and other literature.

The source of data for both studies was based on RCMP proceeds of crime (POC) case files. Due to the small number of POC cases investigated by the late 1980s, the 1990 study was not able to implement a rigorous research design. However, for the second study, much more rigorous methods were used, including the sampling of RCMP POC cases. To ensure a representative sample of POC files, a sampling frame was compiled by identifying relevant POC files from the RCMP Management Information System (MIS), a database of cases investigated by the RCMP. The population of POC cases was refined through the application of criteria intended to maximize the relevancy and quality of the cases to be included in the final sample. The most important criterion for the inclusion of a case in the sampling frame was that the legal definition of “possession of the proceeds of crime”<sup>13</sup> or “money laundering”<sup>14</sup> must be satisfied. To this end, the initial criteria for the inclusion of cases in the sampling frame were as follows: (1) the file was successfully closed between 1993 and 2000 (i.e., the file was closed by the RCMP following the forfeiture of assets resulting from either a conviction or plea bargain); and (2) at least one proceeds of crime seizure or restraint had been made or at least one possession of proceeds of crime or money laundering charge had been laid in the file. Upon application of the preceding criteria to the sampling frame, the MIS database produced a total population of 371 POC cases.

An initial inquiry into the population indicated that additional criteria would have to be applied to screen out certain cases from the final sample. The purpose of these additional criteria was to ensure that all qualifying cases contained sufficient information on how the proceeds of crime were disbursed by offenders (ostensibly minimizing the number of cases that would be unable to supply answers to the questionnaire). The additional criteria used to screen out cases were as follows: (1) the monetary value of the property that was the target of the seizure or

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Cases. Toronto: Nathanson Centre for the Study of Organized and Corruption, York University.

<sup>12</sup> Beare, Margaret and Stephen Schneider. 1990. *Tracing of Illicit Funds: Money Laundering in Canada*. Ottawa: Solicitor General Canada.

<sup>13</sup> *Criminal Code of Canada*, R.S., 1985, c. 42 (4th Supp.), s. 462.3; *Controlled Drugs and Substances Act*, R.S. 1996, c. 19, s. 8; *Customs Act*, R.S., 1985, c. 1 (2nd Supp.), s. 163.1; *Excise Act* R.S. 1985, c. E-14, s. 126.1

<sup>14</sup> *Criminal Code of Canada*, R.S., 1985, c. 42 (4th Supp.), s. 462.31; *Controlled Drugs and Substances Act*, R.S. 1996, c. 19, s. 9; *Customs Act*, R.S., 1985, c. 1 (2nd Supp.), 163.2; *Excise Act*, R.S. 1985, c. E-14, s. 126.2

restraint must be above \$10,000; (2) the case could not simply involve a cash seizure (In other words, if a file was initiated by the seizure of cash by police, to qualify for inclusion in the sample, a proceeds of crime investigation must have subsequently been undertaken. POC files initiated by cash seizures, but where no subsequent investigation took place, generally have insufficient information on how the proceeds of crime are laundered); and (3) the case must involve more than 40 person-hours of investigative time. The application of these additional criteria resulted in a final sample of 149 cases.

A standardized coded questionnaire was prepared to collect data from the RCMP POC case files. The questionnaire solicited information for both a quantitative and qualitative analysis of the data, using close-ended questions (to facilitate a statistical analysis of the data) as well as open-ended questions (to facilitate an in-depth qualitative analysis of money laundering methods and techniques). For some open-ended questions, the answers were collated and coded for a quantitative analysis. Data from the eligible cases was collected by members of the RCMP Proceeds of Crime Sections. Site visits were also conducted among the POC Sections to collect original data and to check the accuracy and completeness of the questionnaires filled out by the police researchers. The data collection took place between January 2000 and May 2002.

Researchers were instructed to examine all relevant documents contained within the case files, in order to identify as much information as possible on the predicate criminal conspiracy, how the criminal proceeds were disbursed by offenders, and any money laundering techniques used. This information generally came from the documents prepared to obtain judicial authorization in executing certain police powers, such as an "Information to Obtain a Search Warrant," an "Application for a Part VI Authorization" (electronic surveillance), or a "Restraint Order." Before police can formally request this type of warrant from a judge or justice, police must include within an affidavit an extensive amount of detailed information on the accused and the alleged criminal conspiracy. In the context of a POC investigation, these documents provided invaluable data for an in-depth analysis of money laundering. Other police documents that proved useful for this study included court transcripts, investigative progress reports, court briefs, intelligence reports, "statement of facts," and wire tap transcripts. Documents obtained by police during an investigation and contained in the case files, such as banking statements, real estate contracts, and correspondence, also proved to be very useful sources of primary data. Personal interviews were also conducted with relevant police investigators and prosecutors to corroborate or elaborate on information contained in these documents, or to provide any information that may

have been absent from the case file. Information from media sources was also used for some cases.

Certain factors conspired to potentially limit the reliability of the data and the ability to extrapolate the research findings to the broader universe of money laundering in Canada. These limitations are the result of the inherently secretive nature of money laundering, the reliance on law enforcement cases as the primary source of data, and problems encountered in selecting a random sample.

The first limitation stems from money laundering itself, which by its very nature is meant to conceal assets from law enforcement. Due to the intrinsically secretive nature of money laundering (which in some cases was pursued with a high degree of sophistication and stealth), there is no guarantee that the POC investigation – let alone this study – was able to identify all of the assets and laundering vehicles associated with a particular criminal conspiracy.

Another limitation is the exclusive reliance on police cases to examine money laundering. Commenting on a researcher's dependency on police data to study organized crime, Tremblay and Kedzier opined, "What documentary sources are pertinent for the analysis of the organization of crime? It is generally agreed that police statistics, while now standardized and fairly reliable, tell us more about the organizational qualities of the police than about crime as such".<sup>15</sup> Indeed, the examples of money laundering included in this study are skewed toward those that have been identified and investigated by the RCMP POC Sections and the IPOC Units. As such, this study must be viewed as an analysis of money laundering as filtered through the enforcement priorities and capacities of the police, and more specifically, the RCMP. Moreover, information that was relevant for the study was not always available from the case files or from other (police) sources. As indicated above, police investigations cannot always identify the full range of laundering vehicles and techniques used by the offenders. This is especially true of the more sophisticated money laundering operations and those that are able to successfully transfer the proceeds of crime and related assets off shore.

Problems were also encountered in the execution of the sampling method designed for this study. These methodological problems revolved around the quality and completeness of the information contained in the RCMP MIS database, which was used to identify the population from which the sample was chosen. In some of the relevant MIS data fields, it

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<sup>15</sup> Tremblay, Pierre and Richard Kedzier. 1986. "Analyzing the Organization of Crime in Montreal 1920 to 1980: A Canadian Test Case." in R. J. Kelly. (ed.) *Organized Crime: A Global Perspective*. Totowa, NJ: Rowman and Littlefield, 78-94.

was later discovered that important information was missing or was entered erroneously. This was detrimental to efforts to draw a random sample, especially when the erroneous information was located in data fields used as part of the filtering criteria. As the study progressed, it also became apparent that the inventory of POC cases contained in the MIS database was not comprehensive. During the latter stages of the data collection, as site visits were conducted among the RCMP POC Sections, a number of cases were discovered that fit the criteria for inclusion in the sample, but were not in fact listed in the centralized database.

### **Research Findings: An Overview**

#### *Offences Generating the Proceeds of Crime*

While there are a number of illegal activities that produce substantial revenues, drug trafficking represents the single largest source of the proceeds of crime (according to this survey). This finding is a reflection of the prominence of drug trafficking in the repertoire of most criminal groups, as well as the priority that the RCMP Proceeds of Crime Program has placed on anti-drug profiteering enforcement. In 111 of the 149 (74.5%) POC cases, a designated drug offence was involved as the predicate criminal activity. Of these 111 cases, 60 (54%) involved cannabis, 59 (45%) involved cocaine, 9 (8.1%) involved heroin, and four (3.6%) involved synthetic drugs. The second most common predicate offence was committed against the *Customs Act* and/or the *Excise Act*, which primarily consists of the highly profitable trade in contraband tobacco and liquor products. The survey included 23 cases (15.4%) where the substantive offence was committed against either of these Acts. Of these 23 cases, 20 involved cigarettes and 16 involved liquor. Offences involving theft or fraud accounted for 11 cases (7.4% of all predicate offences).<sup>16</sup>

#### *Sectors of the Economy Used*

The survey of RCMP cases indicated that the proceeds of crime find their way into a number of different sectors of Canada's economy.

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<sup>16</sup> Theft or fraud offences have long been designated by the RCMP as a low priority for POC investigations, which explains why, statistically, there are only a few POC cases where these offences constituted the source of the criminal proceeds.

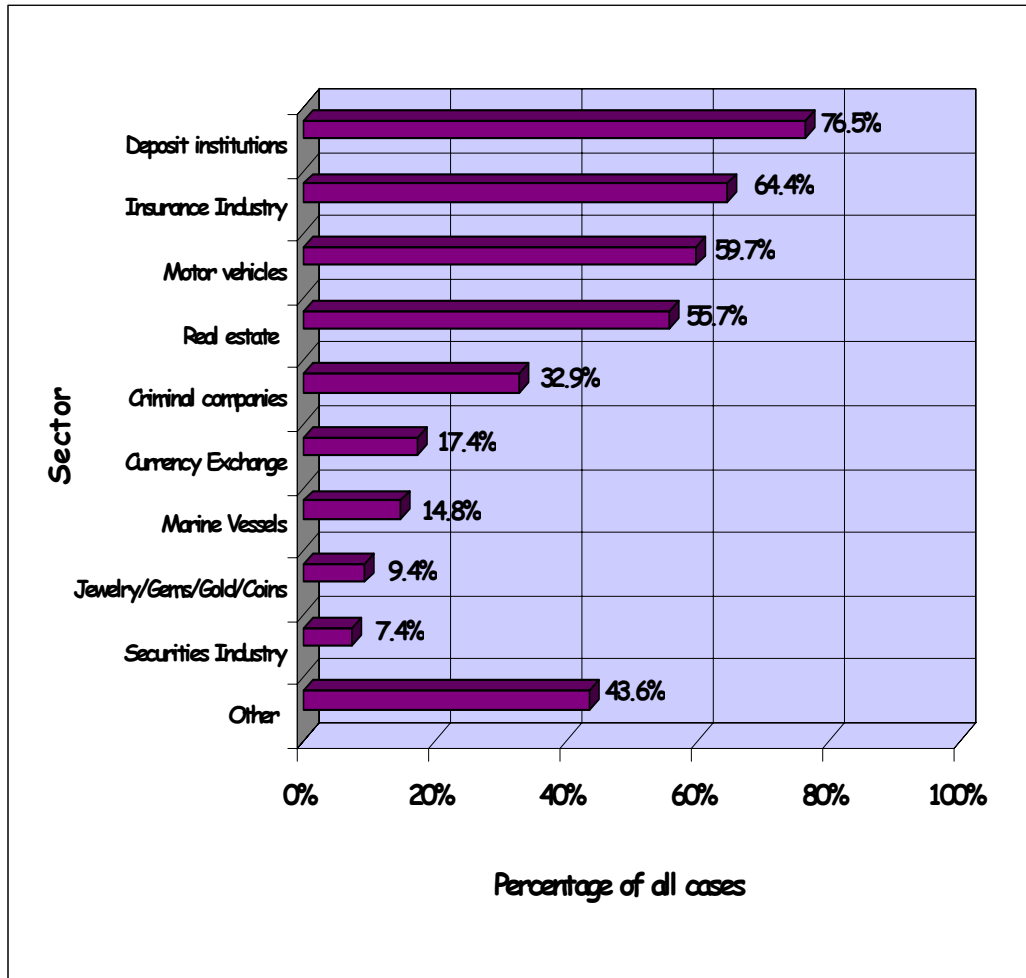


Figure 1 identifies these sectors and the frequency with which each was the recipient of criminal proceeds, based on the survey of POC cases. As indicated in the graph, deposit institutions, the insurance industry, motor vehicles, and real estate are the four most frequent destinations for the proceeds of crime in Canada. Deposit institutions are the single largest recipient, having been identified in 114 of the 149 (76.5%) POC cases. While the insurance sector was implicated in almost 65 percent of all cases, in the vast majority, the offender did not explicitly seek out the insurance sector as a laundering vehicle. Instead, because motor vehicles, homes, companies, and marine vessels were purchased with the proceeds of crime, it was often necessary to purchase insurance for these assets. In a smaller number of cases, the insurance sector was used as a financial service provider to launder the proceeds of crime. In these cases, mortgages, investment certificates, life insurance policies, and mutual funds were purchased from an insurance company or broker. Motor vehicles were purchased or financed with the proceeds of crime in 89 cases (59.7%). Real property transactions were identified in 83 cases (55.7%). In 49 cases (32.9%), companies were established or purchased by an offender to facilitate the laundering process. Currency exchange companies and cheque cashing businesses were implicated in 26 of the cases (17.4%).<sup>17</sup> The purchase or sale of securities was implicated in 11 cases (7.4%). Other assets purchased with the proceeds of crime were marine vessels (22 cases), jewellery, precious gems, or gold (13 cases), rare coins (1 case), art work (3 cases), and livestock, including race horses (6 cases). Legalized gambling, in particular casinos and lotteries, were used to launder funds in 5 cases.

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<sup>17</sup> This figure is skewed upward because included in the random sample were at least 10 cases involving undercover currency exchange companies set up by police.

**Figure 1 – Economic sectors and other assets used for money laundering**



**Money Laundering Through the Securities Market***Source of Funds Laundered*

In all but 1 of the 11 money laundering cases implicating the securities industry, the source of funds was from drug trafficking (the source in the remaining case was cigarette smuggling). Again, this statistic reflects the sheer volume of drug cash that circulates within the legitimate economy (relative to other criminal sources), as well as the RCMP's emphasis on anti-drug profiteering enforcement.

Because the RCMP POC program rarely focuses on securities infractions, no such cases showed up in the sample. However, it is safe to assume that much of the funds generated through breaches, such as insider trading or manipulating stock prices, are at least initially or partially "laundered" through the securities markets, which take advantage of the same processes and vehicles utilized in the original crime (the challenge is often determining when the securities offence ends and the money laundering offence begins). Two RCMP cases from the 1980s demonstrate how the revenues from securities infractions are laundered through the capital markets.

The principals of a publicly-listed company in Canada were involved in the manipulation of its stock, as well as the theft of company's assets. As owners of a large amount of the company's stock, they benefited greatly from the fraud. The stock was eventually sold at an artificially high price, and the proceeds invested into other public companies, through the same trading accounts used for the share price manipulation. The police investigation revealed that the companies, into which the proceeds of these infractions were invested, were indirectly controlled by those behind the original securities infractions.<sup>18</sup>

During the mid-1980's, Edward Carter and David Ward manipulated the shares of 19 public companies listed on the Vancouver Stock Exchange (VSE). The two also paid secret commissions to the portfolio manager of an American-based mutual fund, to purchase \$27-million of stock in 15 VSE-listed companies controlled by Ward and Carter. It was estimated that the pair reaped more than (CDN)\$15 million in profits through the manipulation of these shares, which in turn was laundered through various trading accounts and the purchase of securities and other commodities. In the end, police counted more than 100 trading accounts distributed among 15 brokerage firms in Canada, the U.S. and the

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<sup>18</sup> *Ibid*, note 12 at pp. 121-122.

Cayman Islands. Many of the accounts were registered in the name of beneficial owners and numbered companies incorporated in the Cayman Islands. Carter sold stock to the mutual fund from one account located at the Cayman Island branch of the Canadian brokerage firm Richardson Greenshields Ltd. and which was in the name of the Cayman Island branch of the Royal Bank of Canada. This account was also used to purchase silver and gold bullion, Government of Canada bonds, U.S. Treasury bills and a number of blue chip stocks. By funneling the illicit proceeds of their fraud into commodities and other securities, this trading account was utilized as an important money laundering conduit.<sup>19</sup>

*The Form in which the Proceeds of Crime Enters the Capital Markets*

Unlike the proceeds of securities infractions, which are initially realized as electronic credits in trading and bank accounts, revenue from drug trafficking or other organized crime offences can enter the securities market in a number of forms. Of the 11 cases examined as part of this survey, the criminal proceeds entered the securities market as cash (four cases), monetary instruments (four cases), and account transfers (three cases). The following two cases provide some details on the circumstances surrounding the introduction of proceeds of crime into the capital markets.

A search warrant executed against a suspected cocaine trafficker in Ottawa netted one pound of cocaine as well as cash totalling \$244,000. During the course of the proceeds investigation, it was uncovered that the accused walked into a brokerage firm with a gym bag of cash and invested \$25,000 in stocks. The firm asked no questions in relation to this suspicious transaction.<sup>20</sup>

Two drug traffickers used family members as nominees for bank and trading accounts into which large amounts of drug revenue were deposited. The drug cash would first be deposited in a bank account, often in small denominations. The funds would then be transferred into trading accounts at brokerage firms established in the names of the

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<sup>19</sup> *Ibid*, note 12 at p. 122; *Financial Post*. March 16, 1999. "What was behind the creation of a national exchange?" p. C4.

<sup>20</sup> *Ibid*, note 11 at p. 54.

nominees. Alternatively, the nominees would purchase bank drafts, which were subsequently deposited into their trading accounts.<sup>21</sup>

#### *Brokerage Firms and Money Laundering*

Criminals laundering money through the securities market will more often than not gain access through a brokerage firm. The advantages of using a brokerage firm for money laundering purposes are not only due to its position as a chief point of entry into the stock market for investors, but also because of its ability to operate as a quasi-deposit taking institution, whereby funds can be converted into account credits, securities, or monetary instruments. Brokerage firms can also be used to electronically transfer funds between accounts and between countries.

A drug trafficker named Vincent Patrick Smith was arrested in Amsterdam in 1982 for smuggling drugs and the subsequent investigation uncovered more than \$30,000 in cash and security certificates in a safety deposit box. The investigation also revealed that Smith utilized a Merrill Lynch office to wire transfer money from Canada to Miami.<sup>22</sup>

The Canadian Imperial Bank of Commerce at Portage and Main in Winnipeg reported to police that a customer had walked into the branch with a suitcase full of \$50 and \$100 bills and purchased a bank draft for (CDN) \$81,500 made payable to himself. Bank employees, suspicious of this transaction, notified the police who followed the customer to the brokerage firm Richardson Greenshields. He emerged from this office with a cheque payable to himself for \$59,467.35 in U.S. funds. He then took the cheque to the Royal Bank at 220 Portage Avenue and converted it to U.S. currency. A subsequent investigation revealed the accused performed the same transactions the previous week with (CDN) \$25,000. It soon became evident that the subject was acting on behalf of a close friend who was known to be an active drug trafficker.<sup>23</sup>

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<sup>21</sup> *Ibid*, note 11, at p. 55.

<sup>22</sup> *Ibid*, note 12 at p. 125.

<sup>23</sup> *Ibid*, note 12, at p. 124

*Establishing Multiple Trading Accounts*

One of the common denominators in fraud and money laundering offences that take place within the securities market is the use of multiple trading accounts. In the context of money laundering, multiple accounts are used for “layering,” which is accomplished by conducting multiple transactions and establishing complex hierarchies of asset ownership. In the book *Fleeing the Lamb*, David Cruise and Alison Griffiths demonstrate how a long-established technique to manipulate a stock’s price can also be used to launder money.

A “master” trading account is registered in the name of the individual who is to receive the laundered money. Only legal funds with an easily verifiable source, such as money borrowed from a bank, should enter this account. Nominees then open other trading accounts with the proceeds of crime at a number of other brokerage firms. The master account slowly makes blocks of stock available, which are purchased by the nominees through their various trading accounts. The aim of the master account is to remove a dollar of clean money for every dollar of dirty money used by the nominees. A one-for-one trade between clean and dirty money is considered excellent in the laundering business, and any profits are a bonus.<sup>24</sup>

*Money Laundering Through Derivatives*

The 1998-1999 *Report on Money Laundering Typologies* by the Financial Action Task Force highlights the use of derivatives<sup>25</sup> to launder the proceeds of crime. “Compared to banks,” states the report, “the derivatives markets and associated products represent perhaps a better opportunity for laundering because of the ease with which audit trails can be obscured.” The high volume of trading activity and a high degree of liquidity of the derivatives market, combined with the numerous brokers who trade the products, muddies the connection between each

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<sup>24</sup> Cruise, David and Alison Griffiths. 1987. *Fleeing the Lamb: The Inside Story of the Vancouver Stock Exchange*. Vancouver: Douglas & McIntyre, p. 216.

<sup>25</sup> The FATF defines derivatives as securities with no intrinsic value but which derive their value from an underlying financial instrument or asset. The three primary types of derivative contracts are forward contracts, futures, and options. The report says the instruments “in simple terms, are contracts sold as a hedge against the future risk of fluctuations in commodity prices, time differentials, interest rates, tax rates, foreign exchange rates, etc” (FATF, 1999: 13).

new participant and the original trade. As a result, “no single link in the series of transactions will likely know the identity of the person beyond the one with whom he is directly dealing.” In addition, when compared to bankers’ derivatives, brokers “tend to be less familiar with anti-money laundering efforts”.<sup>26</sup>

Money laundering through derivatives begins with the deposit of criminal proceeds into a trading account. The broker uses the proceeds to purchase 100 derivative contracts, trading at an offer price of \$85.02, with a 'tick' size (which determines the value of each "cent" of a contract) of \$25. At the same time, the broker sells 100 contracts of the same commodity at the bid price of \$85.00. The activity provides two legitimate contracts. Later in the trading day, the contract price, through normal market fluctuations, has changed to \$84.72 bid and \$84.74 offered. The broker closes both open positions at the prevailing prices and then assigns the original purchase at \$85.02 and the subsequent sale at \$84.72 to account “A.” The percentage difference between the two prices is 30 points or ticks (the difference between \$84.72 and \$85.02). The loss incurred in the trade is \$75,000, which is determined by multiplying the tick size (\$25) by the number of contracts (100) and by the difference in price (30). The other trades are allocated to account “B,” which, by following the same calculations, results in a profit of \$65,000. Thus the launderer pays out \$75,000 to receive \$65,000 in laundered funds (a \$10,000 “fee” that is not uncommon in money laundering). The transaction has also created no false documentation and has been conducted transparently in full sight of the market.<sup>27</sup>

*Money Laundering Through Initial Public Offerings of Criminally-Controlled Companies*

Instead of purchasing securities, a criminal enterprise may take the opposite route to launder their illicit proceeds: offering shares in a public company previously injected with criminal proceeds. This allows a criminal organization the opportunity to raise capital, a seemingly legitimate source of funds. Under this method, a private company is incorporated or an existing one is bought by a criminal organization. The

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<sup>26</sup> Financial Action Task Force. 1999. *1998-1999 Report on Money Laundering Typologies*. Paris: FATF, p. 13.

<sup>27</sup> *Ibid* note 26, *Money Laundering Alert*, 1999, at p. 29.

registered owners, directors, and officers of the company are nominees, such as a lawyer or an off-shore shell company. The company may not carry out any legitimate business, but can appear to be highly profitable through the injections of the proceeds of crime, which are made to appear as the legitimate revenue. Shares are then issued to the public in conjunction with a respectable underwriter. The actual laundering occurs after shares are purchased and the “capital financing” is received by the original criminal owners of the company. The objective of this method is to generate a clean dollar through the issuing of shares for every dirty dollar invested in the company before its initial public offering. Because these shell companies can appear to be highly profitable through the injection of criminal profits, the original investors can actually make a substantial profit on their investment through the initial public offering.

In May 1998, the FBI raided the U.S. headquarters of YBM Magnex Inc., a public company listed on the Toronto Stock Exchange. The raid was part of an investigation into suspicions that the company was used by Russian organized crime as a money laundering vehicle. Following the raid, all trading in YBM shares was halted, eventually leading to the company’s collapse. Before the trading was stopped, more than \$100 million was raised from Canadian investors and the firm had a capitalization of close to \$900 million.

YBM was formed in 1991 by its parent company, Arigon Co. Ltd. One of YBM’s original shareholders, and a director of Arigon, was Semyon Mogilevich, reported to be a leading Russian organized crime figure. Arigon was established in the Channel Islands in 1990 and was Mogilevich’s original conduit for laundering money, according to a 1995 British criminal intelligence report.<sup>28</sup> The same report describes Mogilevich as “one of the world’s top criminals” who used YBM “purely to legitimize the criminal organization by the floating on the stock exchange of a corporation which consists of U.K. and U.S.A. companies whose existing assets and stock have been artificially inflated by the proceeds of crime”.<sup>29</sup> Arigon also reportedly had ties to Sergei Mikhailov, a former KGB agent and a suspected leader of the Solntsevo Gang, which, at the time, was reputed to be one of the most powerful crime groups in

<sup>28</sup> *New York Times News Service*. July 27, 1999. “Russian mobsters get rich by duping North American Investors.”

<sup>29</sup> Beare, Margaret. 2000. “Russian (East European) organized crime around the globe.” Paper presented at the *Transnational Crime Conference* convened by the Australian Institute of Criminology in association with the Australian Federal Police and Australian Customs Service. Canberra, Australia, March 9-10.



Moscow, involved in drug trafficking, extortion, smuggling, auto theft, and prostitution. A private forensic investigation into YBM claimed that its six original investors, including Mogilevich, were all members of the Solntsevo group.

A few months later, Arigon established a subsidiary in Moscow known as Arbat International Ltd., which was also used as a laundering vehicle for Mogilevich and Mikhailov, according to the 1995 British intelligence report. In 1991, Arigon bought another Hungarian manufacturing company for \$1.8-million. This company was renamed Magnex and started producing industrial magnets from a plant in Budapest. According to U.S. court documents, the factory was set up in part with stolen equipment and also sold embargoed items such as weapons and enriched uranium to customers in Pakistan and the Middle East.<sup>30</sup> On May 16, 1991, law enforcement authorities in Britain raided the London offices and homes of Mogilevich's lawyers and his former girlfriend and seized files relating to Arigon. British police charged that (US)\$50 million in proceeds of crime passed through the Arigon accounts at the Royal Bank of Scotland over a three-year period.

By the early 1990s, Mogilevich and Mikhailov began to expand into North America. In 1993, an associate of Mogilevich contacted Joseph Bogatin, a Russian academic who lived in the U.S. and specialized in magnet technology. In February 1994, Bogatin left his employer and formed YBM Magnex Inc. in Hatboro, Pennsylvania. YBM then merged with Arigon. In April 1996, Bogatin created Pratecs Technologies Inc., a company incorporated in Alberta and listed on the Alberta Exchange. In October 1996, Pratecs formally acquired YBM Magnex, and changed its name to YBM Magnex International Ltd. By that time, Mogilevich and five of his associates owned just under one-third of YBM's outstanding shares. In 1996, YBM moved onto the Toronto Stock Exchange, and on November 20, 1997, the Ontario Securities Commission approved a \$53-million equity issue at \$16.50 a share.

From the outset, police allege that Mogilevich and his co-conspirators routinely fabricated and destroyed accounting and other financial records, sold products that knew either didn't work or didn't exist, and misled investors and regulators about nearly every aspect of YBM's operations. Court documents suggest that Mogilevich deposited illegal revenues in YBM-related bank accounts in Philadelphia, which were then

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<sup>30</sup> *Globe and Mail*. December 21, 1999. "Russian mob set up YBM office with stolen goods, sold weapons. Court documents also cite money laundering."

disbursed to co-conspirators. The forensic investigation raised serious questions about the firms with which YBM supposedly did business, suggesting that dozens of shell companies were established to act as YBM customers. In Britain, for example, “all companies [are] in the Channel Islands and Isle of Man; many are shells, some are shells within shells; no way to know to this point who the real buyer is,” according to a briefing note prepared by the investigators. In the U.S., the private investigators checked out two supposed magnet buyers and instead “found offices of an attorney. No sign of [either firm]”.<sup>31</sup> Private forensic investigators also found approximately (US)\$2 million in cash at the Budapest factory, which YBM officials explained was for salaries..<sup>32</sup>

In their indictment of Mogilevich, U.S. Attorneys estimated that he made more than (US)\$12 million through the sale of 2.1 million YBM shares held in an account at First Marathon Securities between 1996 and early 1997. The proceeds were then transferred to an overseas bank account he controlled. The indictment also alleges that Mogilevich personally made another \$6 million from bonuses and other compensation from YBM, including sales commissions..<sup>33</sup>

By December 1998, the company was in receivership and in 1999, YBM officers pleaded guilty to conspiracy charges in U.S. Federal Court, admitting that the company was conceived as a vehicle for fraud and money laundering. The company eventually went bankrupt. According to court documents filed by U.S. Government attorneys, Mogilevitch intentionally used Canadian stock exchanges to to launder his proceeds of crime because he felt Canada had lax regulations. Assistant U.S. Attorney, Suzanne Ercole, was quoted in the media as stating, “One of the concepts behind the [money laundering] plan, and the formulation of the plans to take [YBM] and make it a public company and to initiate trading, was to initiate trading on the exchanges in Canada” because they believed that the regulations were more lenient..<sup>34</sup>

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<sup>31</sup> *National Post*. December 10, 1999. “YBM was urged to consider liquidation - then raised \$100-million - warned of 'lack of inventory,' possible 'cooked books'.”

<sup>32</sup> *Globe and Mail*. December 21, 1999. “Russian mob set up YBM office with stolen goods, sold weapons. Court documents also cite money laundering.”

<sup>33</sup> *Globe and Mail*. April 26, 2003. “YBM officers pocketed millions, U.S. says.”

<sup>34</sup> *Globe and Mail*. June 8, 1999. “Mob boss picked Canadian exchanges for YBM scam. Court told Russian selected Canada for alleged money-laundering plan because he thought markets had lax rules.”

*Concealing Criminal Ownership*

One of the necessary components in any successful laundering process is to conceal any association between the criminal owner and the laundering vehicle. Police cases involving the laundering of illicit monies through securities reveal various means to satisfy this essential prerequisite, including the use of nominees, shell companies, and numbered companies.

A member of a Calgary-based organization that trafficked in cocaine and marijuana laundered his illegal revenue through various banks, real estate, and stock market investments. Along with \$113,930 in cash, police seized the following documents from the truck of the accused:

- an account statement from a brokerage firm for the period ending June 30, 1996. The account was registered in the name of a numbered company that was eventually traced to the accused. The Canadian dollar account showed a net value of \$7,938.94.
- a receipt from the same brokerage firm for a different account (but registered in the name of the numbered company) in the amount of \$10,000.
- a mutual fund account statement from a major chartered bank dated July 2, 1996, addressed to the numbered company, showing a balance of \$3,024.17 (Schneider, 2004: 54).

A junior lawyer with a Calgary law firm incorporated numerous shell companies in Canada and off-shore on behalf of a client who was involved in a large-scale drug importation conspiracy.

One shell company incorporated by the lawyer was used to channel more than \$6 million of funds provided by members of the criminal organization to other assets. On one occasion, the lawyer issued a \$7,000 cheque from this shell company to a Vancouver brokerage firm to purchase stock.<sup>35</sup>

A money laundering technique closely associated with the use of nominees is “smurfing,” which involves spreading cash deposits across different bank or trading accounts (and in some cases, different

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<sup>35</sup> *Ibid*, note 11, at p. 55.

companies) by using a number of money couriers (who may also pose as account holders). Smurfs are tasked with making a large number of transactions with small amounts of cash to avoid suspicion and the completion of large cash transaction reports by financial service providers (a money laundering technique referred to as “structuring”). By using a number of smurfs, not only is criminal ownership concealed, but a large amount of illicit funds is spread out to a number of investors and trading accounts, thereby avoiding the added scrutiny of large investments.

Instead of using smurfs, the launderer may assume a different identity.

An individual, long connected with organized crime in Quebec, invested in securities through a number of brokerage firms in that province under an assumed identity. Police estimated that he utilized 20 different identities to facilitate his laundering activities. During a six year period, more than \$2 million was laundered in this manner.<sup>36</sup>

#### *Criminally-Controlled Investment Dealers*

Police cases show that criminal groups will establish their own “investment firms” to further both their money-making and money laundering ventures in the securities market. Controlling a business that purports to facilitate financial investments also opens up an endless stream of money laundering possibilities. Fake clients, shell companies, and nominees can all be used to advance their goals. Paper work can be forged or destroyed. A myriad of obfuscating trades and other transactions can be created. Criminal proceeds can be claimed as start-up capital for both the investment firm and for other criminally-controlled publicly-listed companies that are underwritten by the investment firm. Unscrupulous traders and criminal conspirators can be hired and high pressure sales tactics can be used to sell stock in these companies, thereby generating a clean source of money.

#### *International Transactions and Safe Haven countries*

The ongoing internationalization of securities markets parallels a similar development in money laundering: the increased transborder

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<sup>36</sup> *Ibid*, note 12, at p. 126.

movements of illicit money. Sophisticated laundering techniques are increasingly taking advantage of the integration of the world's securities markets by conducting transactions that cross national borders and by using safe haven countries to obstruct any paper trail. The first step in many international laundering operations is to send the illegal funds offshore, often to a 'safe haven country' with strong bank secrecy laws. Police cases demonstrate a persistent connection between Canada and Caribbean countries in the laundering of illicit proceeds generated from securities infractions and other criminal offences.

The directors and officers of a public company in Canada accused of insider trading utilized accounts at a brokerage firm located in a Caribbean country to launder the proceeds of their activities. The trading accounts were registered in the name of shell companies and hundreds of thousands of dollars of stocks and government bonds were purchased and sold through these accounts. Legitimate loans from Swiss banks were often deposited directly into these accounts in order to justify the large securities transactions.<sup>37</sup>

#### *Securities, Money Laundering and the Internet*

There is a growing fear about the new possibilities for fraud and money laundering offered by electronic commerce, online trading and Internet banking. Police and prosecutors in Italy are on record as saying that organized criminals are laundering their proceeds through e-commerce transactions, sending electronic cash to cyber-accounts located all over the world that then reappear as stocks and shares. The Internet provides anonymity and facilitates international transactions, which is critical to fraud and money laundering. Criminal organizations have the financial resources to buy almost any kind of technological resource or expertise. The Hell's Angels, for example, are known to have their own Internet service provider, an effective way to block attempts by police to monitor their activity on the Internet. Law enforcement authorities in Italy are convinced that the Sicilian mob is convulsing world stock markets by laundering hundreds of millions of dollars through Internet-based investing services. Surges in stock markets are being attributed to online trading and banking by Italian criminals, Italian police say. Police in Palermo uncovered what they said was a

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<sup>37</sup> *Ibid*, note 12, at p. 128.

\$528 million fraud, which they believe is part of a global money laundering scheme. The money was electronically spirited between a U.S. company incorporated in New Zealand, the Cayman Islands, and brokerage accounts in Israel and Spain. It was then deposited into Swiss bank accounts. A Sicilian prosecutor was quoted in the media as saying, "Investigations have highlighted an unregulated and borderless financial market open to anyone with the capacity, for whatever reason, to exchange stocks and money." Mob experts agree that new technology is boosting criminals' coffers while minimizing the risk. "The Internet is a powerful weapon. It eliminates the middleman. There's no need to find corrupt bankers," Mario Centorrino, a professor at Messina University in Sicily, who was quoted by the media.<sup>38</sup>

#### *Utilizing Multiple Laundering Techniques*

The following case demonstrates how a number of techniques employed by criminal entrepreneurs can be used in tandem with one another to launder the proceeds of crime through capital markets.

On December 17, 2001, Lance Boyle was arrested at the Winnipeg Airport in possession of \$115,050 in Canadian cash. The next day, members of Winnipeg Integrated Proceeds of Crime and RCMP Drug Section executed a search warrant at a home owned by Boyle and an associate identified as Willie Van Houghton. During this search, approximately \$19,870 in Canadian currency, \$9,045 in U.S. currency, \$25,000 worth of anabolic steroids, and two pounds of cannabis were seized. By the end of the investigation, a total of 89 drug and proceeds of crime charges were laid against 20 individuals involved in this drug trafficking network. A forensic audit conducted as part of the investigation estimated that between 1996 and 2000, Boyle had unexplained income of approximately \$775,000. The proceeds of crime investigation into Boyle and Van Houghton revealed that both were active investors in the stock market and had amassed impressive portfolios, although neither had declared any income over the past several years. Police were able to connect 15 investment accounts, located at 11 different banks, brokerage firms and fund managers, to Boyle, and while some were registered in the name of relatives, he was authorized to trade

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<sup>38</sup> *United Press International*. December 23, 1999. "Internet used to launder money."; *Chicago Sun-Times*. December 13, 1999. "Mob exploiting Net, Italian police claim."

through all of them. Police ultimately proved that the funds in accounts registered in the names of Boyle's mother and brother were derived from criminal activity. In addition, Van Houghton managed a company called Investing Networks Ltd., which police described as operating in a manner similar to a mutual fund. Through the course of their investigation, the RCMP determined that Boyle and Van Houghton had established accounts at 10 brokerage firms in Canada, including some of the largest in the country. Shortly after the arrest of Boyle and Van Houghton, money and securities were transferred among a number of brokerage accounts, in the name of the two accused, as well as relatives and other nominees. Accounts were also registered in the names of shell companies established by Boyle. One such company was BSE Investments, which opened an account with a major brokerage firm on June 25, 2000. From that day until June 30, four deposits totalling \$67,500 were made into this account. In addition, \$17,000 was transferred from Boyle's account at another brokerage firm to that of BSE Investments. Following Boyle's arrest, there was a dizzying movement of funds from bank and investment accounts he directly or indirectly controlled. Shares in a public company called Edusoft Inc., were transferred from BSE Investments' account to the account of Boyle's brother. An additional \$27,000 was withdrawn from the brother's investment account and transferred to his bank account. The funds were then moved to the mother's account at another bank and subsequently transferred to her account at Investing Networks Ltd. She also opened an account at another investment firm with a deposit of \$17,000. The sources of these funds were in the form of two cheques, which were drawn from two investment accounts in the name of Lance Boyle (one of which was opened after he was arrested). The mother also wrote a \$25,000 cheque to Investing Networks Ltd. from a bank account in her own name, which was deposited into another account at the same bank in the name of Investing Networks. The \$25,000 cheque was preceded by a deposit of \$25,000 on the same day from a bank account in the name of Boyle's brother. The source of the funds appears to be a \$25,000 cheque, drawn from the brother's brokerage account a month earlier. The funds in this account were from the sale of Edusoft shares, which were transferred to the brother from BSE Investments' account.<sup>39</sup>

### **Conclusion**

A microcosm of contemporary organized crime can be found in its involvement in the capital markets. Through the use of "pump-and-

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<sup>39</sup> *Ibid*, note 11, at pp. 54-55.

dump” schemes, criminal groups are once again relying on fraud and other predatory practices to make money. The involvement of organized crime in the securities market is also marked by a growing sophistication, which is reflected in the evolution from the physical theft of security certificates in the 1950s, to technology-assisted offences in the 1990s and beyond. Despite such sophistication, organized criminals still rely on such tried and true tactics as intimidation, violence, and corruption. Police cases also show that criminal groups will cooperate with one another to further their efforts to manipulate and defraud the financial markets. In their infiltration of the capital markets, organized crime groups pursue a dual purpose that is ubiquitous to their interest in other economic sectors: to make money and to launder money.

In the quest to legitimize revenue from unlawful activities, criminal entrepreneurs take advantage of a wide range of sectors, services, transactions, and professionals in the legal economy. The statistical findings of the study that informs this article appear to suggest that the securities market is not as much at risk of money laundering as other financial sectors. This may very well be true, but one cannot ignore the ongoing threat posed to the capital markets by well-organized criminal entrepreneurs to make and launder money. The destructive repercussions of organized crime involvement in the securities market include the use of graft, intimidation and violence against industry participants, unfair competition, investor losses, an erosion of market integrity, and investor confidence. A rise in electronic and private trading, the ease of accessing capital markets all over the world, and the increasingly deregulated nature of the capital markets make it increasingly vulnerable to fraud and money laundering.

In November 2002, the Ontario Securities Commission (OSC) acknowledged that organized crime is active in the capital markets across Canada through money laundering, manipulating share prices, and conducting insider trades. “Organized crime has realized that in a marketplace where hundreds of millions of dollars are trading everyday it would be lucrative if they could get their tentacles into it,” according to Michael Watson, director of enforcement at the OSC.<sup>40</sup> The OSC’s recognition of the involvement of criminal groups in Canada’s stock markets is not new; in 1999 it called for a formal partnership between itself and the RCMP in part to crack down on “a disturbing growth in crime in the securities industry, crimes to which a very large degree have been committed by organized syndication”.<sup>41</sup>

In response to these threats, the federal and provincial governments have undertaken a number of legislative, administrative,

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<sup>40</sup> *National Post*. November 13, 2002. “Dirty Funds Haunt Small Exchanges.”

<sup>41</sup> *Globe and Mail*. October 27, 1999. “OSC Warns Of Rising Securities Crimes: Calls For Full-Time RCMP Fraud Squad Policing Markets.”



and operational actions. In 2003, the Federal Solicitor General announced the formation of the Integrated Market Enforcement Teams (IMETs), which are mandated to respond to major capital market fraud and other market-related crimes. The IMETs are composed of RCMP financial crime investigators, lawyers, as well as forensic and analytical support and are expected to work closely with securities regulators.<sup>42</sup> It is yet to be seen with the IMET or the RCMP POC Sections whether there will be greater attention paid to investigating money laundering and terrorist financing in the securities markets.

The Canadian government has also introduced legislation that requires investment dealers and advisors, as well as other financial service providers, to identify and report large cash and suspicious transactions.<sup>43</sup> These new laws are unprecedented given the legal onus placed on the private sector to report suspected criminal activity, and have ostensibly drafted the private sector to fight on the front lines in the war against money laundering and terrorist financing. In ensuring they live up to both the letter and spirit of these federal transaction reporting laws, financial service providers will need to implement policies and operational practices to detect and report large cash and suspicious transactions, designate compliance officers, conduct ongoing risk assessments, train staff, and conduct greater due diligence among current and prospective clients.

Some provincial securities regulators have gone so far as to require their member brokerage firms to report how many offshore accounts their clients hold, and what kinds of due diligence the dealers make when the accounts are opened. The regulators also want investment dealers to describe its "policies and procedures for opening new accounts from offshore jurisdictions, whether brokers ask offshore clients about the source of funds, and under what circumstances the brokerage would make independent inquiries about where the money comes from".<sup>44</sup>

In the wake of the collapse of YBM Magnex, the OSC aggressively pursued those who it felt shirked their fiduciary responsibility (an inquiry that also risked exposing the Commission's own lack of pre-emptive regulatory acumen in this case). On May 7, 2001, the OSC began hearings into the YBM debacle, alleging that nine corporate

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<sup>42</sup> Solicitor General Canada. 2003. "First-Ever Integrated Market Enforcement Teams Target Capital Markets Fraud." *Solicitor General Canada Press Release*. November 28.

<sup>43</sup> *Proceeds of Crime (Money Laundering) Act*. Chapter 17, Statutes of Canada 2000.

<sup>44</sup> *Canadian Press*. October 29, 2001. "Money laundering worries leads regulators to ask about offshore accounts."

officers and board members (including former Ontario premier David Peterson), two brokerage firms, and a senior partner in a the law firm Cassels Brock and Blackwell, knew about allegations that the company's founders had ties to Russian organized crime, but failed to disclose these material facts in their prospectus.<sup>45</sup> The OSC sought to ban some directors from the Ontario markets or directorships and recommended the brokerage firms be prohibited from underwriting stock offerings for up to a year.<sup>46</sup> Shareholders also took matters into their hands by launching a class action suit in the United States against many of the YBM principals investigated by the OSC. In February 2002, a settlement was reached where shareholders were promised 25 to 33 cents on the dollar.<sup>47</sup>

Together, these disparate and uncoordinated initiatives demonstrate the need for a strategic, nationally-coordinated, multi-sectored approach to combating the problem of (organized) crime in the capital markets. Such a coordinated, strategic effort must also include a greater emphasis on proactive and preventative measures among the investing community, the securities industry, regulators, policy-makers, and law enforcement. A comprehensive and integrated approach in dealing with organized criminality in the securities market is particularly important given the self-regulatory vulnerabilities that have been exposed in recent years. These self-regulatory limitations were acknowledged in a 1998 statement by the senior vice-president of the market regulation for the Toronto Stock Exchange, who confessed, in the wake of the YBM scandal, that it was unrealistic to expect exchange officials to amass information on everything and every individual associated with a company when it applies for an exchange listing. "If you have to carry out a ... forensic accounting audit any time somebody wants to list here, we'd have to go out of business," he said.<sup>48</sup>

The threat of organized crime infiltration into the securities market, and the need for a nationally-coordinated effort, is also highly

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<sup>45</sup> *Toronto Star*. July 10, 2001. "Probe at YBM Magnex outlined. Investigator testifies to OSC panel." p. F06.

<sup>46</sup> *National Post*. October 16, 2002. "OSC seeks long ban for Peterson: 'Failed to exercise reasonable diligence' while on YBM board." p. FP1; *National Post*. October 17, 2002. "YBM penalties would be 'death knell' for 2 brokers: Possible sanctions for Griffiths, National Bank." p. FP1; *Montreal Gazette*. October 26, 2002. "OSC suggests heavy penalty: Natbank is target. Brokerage might face ban of up to a year." p. B1.

<sup>47</sup> *National Post*. August 28, 2000. "Law firm named in U.S. case against YBM." p. C1.; *National Post*. February 8, 2002. "YBM case nets \$85M. Shareholders win biggest settlement of its kind in Canada."

<sup>48</sup> *Globe and Mail*. May 23, 1998. "How YBM Magnex got to market. Questions are swirling over how the industrial magnet maker."

germane to the contentious debate over whether the current system of provincial regulation should be replaced by a national body. Suffice to say, the securities markets are now global in nature, with technology allowing investors to trade stocks in Canada from a personal computer as far away as Brisbane or Kuala Lumpur. The recent mergers of stock exchanges in Canada also portend the need for some rationalization and centralization of securities regulation in this country. It is abundantly clear that organized fraud and money laundering operations are now multinational in nature, casually ignoring jurisdictional boundaries. Research and police cases show that organized criminals readily take advantage of jurisdiction limitations, weaknesses, and fractionalization within enforcement and regulatory regimes.

The current structure of securities regulation in Canada seems to be less about efficiency and effectiveness, and more about power relations within Canada's highly decentralized federalist system of governance. It must be recognized that, whatever regulatory and enforcement system is in place, jurisdictional boundaries will create greater inefficiencies and obstacles in enforcement and regulation, while benefiting the astute, multi-jurisdictional, criminal organization. The creation of the IMET teams is one step in the right direction; however, what is needed is a truly integrated, national body that encompasses all the necessary administrative, regulatory and enforcement powers and resources to respond to and prevent potential malfeasance within the securities market. One possible prototype – which is in place in an entirely different industry, but one that is also highly susceptible to crime and organized crime, in particular – is the Waterfront Commission of New York Harbor. At the New York and New Jersey marine ports, crime and corruption were viewed as so endemic that a unique institution was created to address these inter-related problems. The Waterfront Commission epitomizes efforts to address a significant criminal problem by integrating all available regulatory, administrative, and criminal enforcement tools within one comprehensive, strategic, and multi-disciplinary agency. Indeed, the Waterfront Commission is unique and innovative due to its combined regulatory and enforcement mandate, a focus that is both proactive (screening, licensing, audits, compliance examinations) and reactive (investigations, civil and criminal injunctions and sanctions), with a multi-disciplinary approach (which includes police investigators, intelligence analysts, legal counsel, labour specialists, and forensic accountants).<sup>49</sup>

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<sup>49</sup> Kaitz, Joseph. 1975. "The bulwark against organized crime on the waterfront." *Police Chief* 42(2):38-39; Waterfront Commission of New York Harbor. 1998. *Annual Report 1997/98*. New York: The Commission; *New York Times*. October 29, 1998. "Report ties union official to the Gambino

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crime family.”