

## The Impact of Criminal Misuse of Secret Companies on Canadian Small-Medium Enterprises and Rationale for a Publicly Accessible Company Register of Beneficial Owners

This briefing note discusses how criminals can hide their identity behind secret companies, which harms the Canadian economy, particularly Small-Medium Enterprises (SMEs). We propose a policy mechanism to deter bad actors from using secret companies to facilitate the proceeds of crime. This policy solution would alleviate administrative and regulatory due diligence costs for SMEs.

### Bad Actors Can Abuse Secret Companies and Put Honest Small Businesses at Risk

In today's complex business and financial environment, it is increasingly important for businesses to conduct thorough due diligence before making critical decisions in their supply chains. Knowing exactly who they are doing business with enables companies to make informed decisions about transactions and business relationships.

Companies' efforts are geared towards generating profits and maximizing shareholder value. This is not the case for most secret companies. They exist only on paper for the sole purpose of hiding the identity of a bad actor operating behind the scenes. Criminals can remain anonymous for a variety of nefarious activities including committing fraud, embezzling company funds, and paying bribes and distorting market prices—posing serious risks to legitimate small and medium enterprises.

There are thousands of legitimate shell and shelf companies in Canada. Yet, Canadian shell companies are being marketed abroad for tax evasion schemes and used to launder billions of dollars into the Canadian economy.<sup>1</sup>

### Ways in Which Secret Companies Have Been Abused in Canada

#### » **Secret companies have been abused to deploy phishing schemes in order to win procurement contracts**

In 2017, a fraudster swindled Edmonton-based MacEwan University out of \$11.8 million by deceiving the institution with phishing emails<sup>2</sup>. He then moved the funds into a shell company, thereby concealing his identity. The funds, which were meant to be invested in a new state-of-the-art building on campus, were transferred into a bank account in Hong Kong. Because the shell company was established without disclosing its beneficial owners, it was exceptionally challenging for authorities to navigate a complex money-laundering scheme to track down the perpetrators. Many stakeholders in the community were adversely affected. Students were victimized, and contractors and vendors suffered heavy financial losses.

#### » **Secret companies have been abused by money launderers and have contributed to market volatility in international capital flows and exchange rates**

One of the reasons for creating a shell company is to launder the proceeds of crime, which has severe socioeconomic implications. In Canada alone, there are estimates of between \$100 to \$130 billion being laundered each year.<sup>3</sup> Unlike legitimate investors, money launderers do not seek profit maximization.

1 <https://business.financialpost.com/investing/global-investor/heres-how-the-shell-companies-exposed-in-the-panama-papers-work>

2 <https://www.cbc.ca/news/canada/edmonton/macewan-university-phishing-scam-edmonton-1.4270689>

3 [https://www.cdhowe.org/sites/default/files/attachments/research\\_papers/mixed/Final%20for%20release%20e-brief\\_291\\_web%20%28003%29.pdf](https://www.cdhowe.org/sites/default/files/attachments/research_papers/mixed/Final%20for%20release%20e-brief_291_web%20%28003%29.pdf)

They seek a reduced risk of getting caught for their crimes. Their lack of vested interest adversely affects legitimate business.

One only needs to look at British Columbia's Lower Mainland, where a firm called Silver International allegedly acted as an underground bank for money flowing from China. Money services businesses in Canada are federally obligated to register their business and create customer profiles. Silver International did neither and was alleged to have laundered up to \$220 million in a year<sup>4</sup>.

Money laundering of this magnitude has ripple effects across the economy by creating unpredictable changes in demand and extreme volatility in international capital flows and exchange rates. As a result, honest business owners, entrepreneurs, and investors are those who bear the brunt of money laundering in the economy.

### » **Secret companies have been abused to encourage theft against honest, legitimate enterprises**

Shell companies can also be established for hiding funds obtained through fraudulent activities. In one recent case, an employee of an Alberta-based oil and gas business stole more than 6,000 pounds of chemical products from a local enterprise. The employee and his partner are facing charges of fraud after exporting the stolen product to the U.S. Investigators believe the couple used a shell company to facilitate the sale of the chemicals, which were worth more than \$700,000.<sup>5</sup>

## **Policy Recommendation to Prevent Bad Actors from Abusing Secret Companies**

### » **A pan-Canadian publicly accessible company registry of beneficial owners**

According to Ernst and Young's 2016 Fraud Survey,<sup>6</sup> 91% of senior executives believe it is important to know the ultimate owner of the entities with which you do business. The most pragmatic way to bring transparency to the system is to create a pan-Canadian publicly accessible registry of beneficial ownership. Such a registry would require disclosure of the basic business information of those who ultimately own or control more than 10% of the shares of a company. The registry would not require any disclosure of financial or operational information of the company or personal details about its shareholders.

### » **Additional benefits of a registry**

More than 31,000 Canadian financial institutions, designated businesses, and professions are required by the Canadian anti-money laundering and terrorist financing laws and regulations to conduct due diligence on their clients. A public registry would significantly reduce the administrative burden facing thousands of businesses across Canada. "Canadian firms can encounter a higher regulatory burden than their peers"<sup>7</sup>, states a recent scorecard by Deloitte and survey assessment by the Business Council of Canada. That same assessment also found that 41% of its members believed that a reduction of regulatory burdens would be "one thing to improve Canada's business environment."<sup>8</sup>

By having this information in a centralized repository, business owners would benefit from not having to repeatedly duplicate due diligence forms. A publicly accessible company registry of beneficial owners has a dual benefit of deterrence and facilitates doing legitimate business in Canada. In short, a public registry would prevent those who plan to use secret companies for nefarious purposes from incorporating in Canada, and it would also relieve SMEs of some of their present regulatory costs.

4 <https://vancouver.sun.com/news/local-news/company-laundered-up-to-220-million-b-c-civil-forfeiture-office-alleges>

5 <https://edmontonjournal.com/news/crime/edmonton-couple-charged-with-stealing-774400-in-chemicals-from-edmonton-company>

6 [https://www.ey.com/Publication/vwLUAssets/ey-global-fraud-survey-2016/\\$FILE/ey-global-fraud-survey-final.pdf](https://www.ey.com/Publication/vwLUAssets/ey-global-fraud-survey-2016/$FILE/ey-global-fraud-survey-final.pdf)

7 <https://www2.deloitte.com/content/dam/Deloitte/ca/Documents/finance/finance-bcc-deloitte-scorecard-interactive-aoda.en.pdf> (slide 38)

8 Ibid.