

MEASURING CORPORATE CRIME IN CANADA

Project Summary

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Executive Summary: The Capital Markets Institute (“CMI”) is creating a “Corporate Scorecard” intending to approximate annual levels of financial crime in Canada. Using Dorothy Lund and Natasha Sarin’s paper, “Corporate Crime and Punishment: An Empirical Study”, we sought to establish a model for measuring financial crime in the Canadian context.¹ At this stage in the project, we were able to identify several potential proxies and to develop an understanding as to which regulatory and law enforcement agencies might already be tracking financial crimes privately. This report explains our proxy selection and suggests further avenues of research and targets for outreach to access additional data.

I. Defining Financial Crime

“Financial crime” is a definitionally fluid term that implies different parameters when used in different contexts. Most typically, the term is broken down into two categories: (i) fraud in its various forms, (ii) money laundering and “other criminal transgressions”, including bribery, tax evasion, and using the financial services system in furtherance of a criminal enterprise.² This project focuses largely on financial crime committed at an organizational level *and* which impacts the integrity of Canada’s capital markets and/or financial systems. As such, we ignore potentially impactful individual crimes (e.g. isolated insider trading) and seek to account for them once they reach a critical mass within the organization (e.g. prolific insider trading resulting from corporate governance issues). However, Part III, Data Sources 5 and 6 identify potential expansions to the project’s definition of “corporate crime” outside the strict parameters of financial crime.

II. Measuring Corporate Crime - Proxy Selection

Given the definitional fluidity and covert nature of corporate crime, any models for estimating corporate malfeasance will give, at best, a rough sketch of the issue. Moreover, there is no singular entity in Canada which has as its purpose the investigation and prosecution of all types of financial or corporate crime. Due to these issues, we chose a “parts of the whole” approach to measurement. We identified six entities as data sources that each cover a particular aspect of corporate crime, although there is overlap. Then, we have either selected potential proxies from each source or have explained why that source failed to provide an appropriate proxy. This failure was typically due to a paucity of publicly-accessible data.

¹ Lund, Dorothy S. and Sarin, Natasha, Corporate Crime and Punishment: An Empirical Study (February 17, 2020). U of Penn, Inst for Law & Econ Research Paper No. 20-13, Available at SSRN: <https://ssrn.com/abstract=3537245> or <http://dx.doi.org/10.2139/ssrn.3537245> [Lund].

² “Financial Crime or Fraud?”, Mckinsey, <https://www.mckinsey.com/business-functions/risk/our-insights/financial-crime-and-fraud-in-the-age-of-cybersecurity>.

Though this approach will likely be underinclusive, we feel it is particularly appropriate in the Canadian context given that Canadian initiatives in combating financial crime have tended to take a piecemeal approach. For example, the Financial Transactions and Reports Analysis Centre of Canada's (FINTRAC) statutory mandate is to narrowly detect, deter and prevent money laundering and terrorist financing.³ In addition, capital markets regulation occurs at a provincial level, creating disjunctive measurement initiatives between the provinces. For example, only three provinces, Ontario, British Columbia, and Alberta, have financial crime whistleblowing programs (though regulators tend to collaborate with IIROC, which has a national whistleblowing program for its regulated entities). As a result, existing metrics that could feasibly be applied to approximating levels of financial crime in Canada tend to be targeted at "one piece of the puzzle". The opaque and complicated relationship between provincial police services and the RCMP with regard to the prosecution of financial crimes further compounds the difficulty in identifying proxies.

Finally, we note that the same shortcomings that detract from the Lund and Sarin paper also affect this project. By definition, a proxy can only *approximate* underlying levels of corporate crime. It is difficult to determine whether there is any correlation of any selected proxy with the actual commission of underlying crime, and more difficult still to estimate the strength of that correlation. This is, of course, because the actual rate of corporate crime is unknown. Selecting useful proxies in the Canadian context is perhaps more difficult than in the US because certain facets of our anti-corporate crime regime are relatively newer. For example, it is only in the past five years that provincial regulators have begun instituting whistleblower regimes. Due to the newness of these facets of our anti-corporate crime regime and the correspondingly short period of recorded data, it is difficult to say with certainty that any given change in a proxy is actually being caused by a change in the underlying rate of corporate crime. It could easily be argued that the change was actually due to a confounding factor such, for example increased knowledge of the agency, increased take-up rates, or internal policy changes at a financial institution or government agency.

These issues should become less pronounced over time. As time goes on, agencies like FINTRAC and the SFO will mature and knowledge of tools like the provincial and IIROC whistleblower programs should become more widespread, making it easier to account for increases due to take-up or internal policy changes. Equally as important, CMI will have a more robust dataset with a longer time-series, which will make it easier to recognize broader trends and to account for confounding variables.

³ Financial Transactions and Reports Analysis Centre of Canada. (2021, March 19). *Welcome to FINTRAC*. Welcome to the Financial Transactions and Reports Analysis Centre of Canada. <https://www.fintrac-canafe.gc.ca/intro-eng>.

III. The Proxies

In their paper, Professors Lund and Sarin identified three data sources they suggested as proxies for the underlying rate of corporate crime committed by employees of large public corporations and financial institutions in the US. These three data sources are: 1) Financial Crimes Enforcement Network (FinCEN) Suspicious Activity Reports (SARs); 2) consumer complaints made to the Consumer Financial Protection Bureau (CFPB); and 3) whistleblower complaints made to the SEC. It is not possible to use precisely analogous sources in the Canadian context as the structure of our financial system, and the regulatory regime in place to police it, is not identical. For example, in its annual reports, FINTRAC publishes the absolute number of Suspicious Transaction Reports (STRs) it receives each year. While STRs appear superficially to resemble FinCEN's SARs, the narrower mandate of Canada's FINTRAC as compared to the US's FinCEN means that the two reports may capture different data. Moreover, the various whistleblowing regimes that have been instituted in Canada are all younger than the analogous regimes in the US; as a result, there is a relative paucity of long-term data that exists for this metric. This is not to say that either FINTRAC's STRs or the whistleblowing data of the OSC or IIROC should be discarded as potential proxies, but rather to explain why the metrics suggested by Professors Lund and Sarin cannot simply be duplicated in the Canadian context.

In our research, we identified the sources of data that may yield proxies which can estimate underlying levels of corporate crime in Canada. It must be stressed that the biggest limitations we faced were a lack of publicly available data and difficulty establishing contacts with the regulatory agencies and police services described below. It is entirely possible, and likely, that each entity listed below internally compiles sources of data that might make for more useful or accurate proxies. We struggled with the fact that we often knew that "we did not know what we did not know"; in other words, we found it challenging to ask these entities for data without knowing exactly what data they already track and therefore what might make useful proxies for this project. Unfortunately, we were not able to establish cooperative contacts at each agency who would be willing to take us through their datasets so that we could work together to identify accurate proxies of corporate crime. This is not to say that such contacts do not exist; only that we had trouble establishing them, perhaps due to the communication breakdown endemic to the Covid-19 pandemic. Given that we believe better proxies are likely being tracked by entities that would likely be willing to work with CMI, it is perhaps best to consider the below list as illustrative of greater sources of data that likely exist and might be available to CMI upon further request.