

“The Price of Crime”
“The Risks to Business Presented by Organized and Economically Motivated Criminal
Enterprises

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The Risk – It's all about Reputation

Today, I would like to focus my comments on the risk to business generated from organized and economically motivated criminal enterprises to that of risk to reputation. It is my personal belief that loss of reputation can be the ultimate price of corporate crime and for the purposes of this discussion, I will refer to three distinct aspects. Firstly, I hope to have you consider the implications of loss of reputation with respect to regulators and law enforcement, secondly, with respect to shareholders, and finally, with respect to their very own employees.

To begin, I ask that you to reflect on the changes in recent years with regard to the social acceptability of corporate crime. I would suggest that we have moved into a new era – one in which it has finally become socially unacceptable to be involved in any form of corporate crime. Think for a moment of other types of behaviour that have become socially unacceptable and eventually illegal. For example, think back to a time not all that long ago when drinking and driving were considered to be generally accepted, even winked at. Some of you may remember the movie 'Cannonball Run' of the 1970s - Dean Martin was dressed as a priest and sipping from his glass of scotch as he weaved uncertainly to the cockpit of his Ferrari? It was hilarious. Everyone got a laugh -- in part, because so many of us did exactly the same thing (although perhaps not in a Ferrari). Candy Lightner, the founder of Mothers against Drunk Drivers or MADD once described drunk driving as being the only socially acceptable form of homicide. She further commented that Judges do it, Juries do it and District Attorneys do it and that we were in fact dealing with a crime that is not considered a crime by society. That, of course, has all changed today. It's no longer funny at all to get soused and get behind the wheel. In fact, driving drunk became the object of a neo-Prohibitionist crusade. It's now looked down upon as grubby and low class. Those who drive with even a little alcohol in their system are mercilessly crucified if caught -- and regarded as leprous idiots by most right-thinking people

Now lets move on to other types of crime that were once, and in some cases still are, considered socially acceptable. White collar crime, corporate fraud, securities fraud, capital markets fraud and accounting fraud are all terms that are almost used interchangeably but all generally refer to the same thing – fraud against business. Or, to refer back to the title of this particular symposium – 'business crime'.

In 2003, a consulting firm in the United States reported that nearly one in four respondents to a survey indicated that they thought it was acceptable to overstate the value of an insurance claim. In 2000, the Insurance Research Council (IRC) reported that 35% of the people it surveyed responded that it was acceptable to increase the amount of a claim to make up for a deductible. In fact, year after year, IRC surveys report that one-quarter to one-third of respondents indicate that respondents believe it is acceptable to exaggerate claims for one reason or another. The IRC uses the term "soft fraud" to label the "exaggeration of otherwise legitimate claims." I ask that you please remember that term – 'soft fraud'.

I am a law enforcement officer in the Royal Canadian Mounted Police and in that capacity, I also have the distinction of being the Director of a Canadian program targeting capital markets crime

in Canada entitled “Integrated Market Enforcement Teams” or IMETs. As such, I have a personal appreciation for the term ‘soft fraud’.

It was not very long ago indeed that people viewed corporate crime as victimless crime. They rationalized that large financial institutions had lots of money and if they got some they were not hurting anybody. People could also be quite taken with corporate criminals and often tended to romanticize media reports of successful corporate insiders making hundreds of millions of dollars at the expense of some relatively unknown corporate conglomerate.

In fact this conception of ‘soft fraud’ became so prevalent that some jurisdictions actually developed a citation-in-lieu-of-detention program. For example, in 2002, the Arizona Department of Insurance Fraud Unit announced that those who commit single, lower dollar amount acts of fraud would now be issued a citation, or ticket for a misdemeanor or petty offense. Acts subject to citation would include theft under \$250, attempted theft, solicitation of theft, solicitation of fraudulent insurance claim, solicitation of insurance fraud, AND false reporting. The Department of Insurance worked closely with the Attorney General's Office and county courts to develop this program.

Now we reach the theme of my talk today. I believe that we are moving from an era in which corporate crime was not considered a crime by society to one in which the crime in corporate crime is finally being recognized for what it is. We are in a new era - one in which investors and shareholders, in fact all stakeholders, have woken up to see the true cost of corporate fraud. The wake up call was very expensive as we have witnessed accounting scandals of unprecedented proportion. All walks of people can now appreciate a definite link between this thing called corporate crime and the loss of ones personal life savings.

One of the better examples of this lies in the story of Bre-X Minerals Ltd. Bre-X purchased a gold mine in the Busang jungle and in October, 1995 announced significant amounts of gold had been discovered, sending its stock price soaring. Originally a penny stock, its stock price reached a peak at \$286.50 with a total capitalization of over \$6 billion Canadian dollars. The gold reserves at Busang were alleged to be 200 million ounces (6,200 t), or up to 8% of the entire world's gold. However, it was a massive fraud and there was no gold. The core samples had been faked by salting them with outside gold. An independent lab later claimed that the faking had been poorly done, including the use of shavings from gold jewelry. In 1997, Bre-X collapsed and its shares became worthless in one of the biggest stock scandals in Canadian history. Among the major losers were three Canadian public sector organizations: The Ontario Municipal Employees Retirement Board (loss of \$45 million), the Quebec Public Sector Pension fund (\$70 million), and the Ontario Teachers Pension Plan (\$100 million).

So, what do we do about corporate fraud? We start by demanding that our Governments do something about it - the public began demanding that ‘soft fraud’ be treated like ‘hard fraud’. The weight of these demands soon fell upon the shoulders of lawyers and legislators who are the supposed monitors of socially acceptable behavior. They decide which law should apply in cases of commercial and financial crimes and whether there is a need for new laws. When reforms are needed, they make recommendations on the form and content of the new regulations, and assess

the effects of these new regulations on the rest of the social system.

Media reports and criticism of the role of law enforcement in commercial and financial fraud crime has often resulted in the portrayal of law enforcement as being either controversial or insufficient or, sometimes even incompetent. Criminal law was often also seen as weak and reactive in this regard - a large number of financial fraud cases led to insolvency, and civil remedies usually came too slowly. Many in the financial services and security industry became convinced of the limitations of law enforcement and the limitations of criminal prosecutions in this area. Combine all of this with a worldwide belief that commercial and financial fraud has increased considerably in the last two decades and enter an era where government were driven to seek out new ways to enhance the role of criminal enforcement. The common investor, and the entire business world behind them, were demanding that these crooks be treated like criminals and that there is indeed a genuine threat of investigation, prosecution and subsequent incarceration.

In previous years, I reported that the government of Canada took steps in 2003 to enhance the protection of commercial and financial institutions against crimes that eat away their profits. We are particularly committed in protecting the private individual against corporate fraud.

In Canada we also have a particular concern for the effects of commercial and financial fraud on our general economy. We all know that cases of financial fraud lead to a general loss of market confidence. Media relationships then become strained as companies try to refrain from disclosing too much information, leaving plenty of room for speculation. This in turn can translate into a general flight of capital.

Worldwide, governments are of the realization that there will be a number of consequences if we allow these scandals to continue. First, prospective shareholders will demand a higher return on their investment to justify the higher risk of stock investment because trust in corporate management will go down. This will increase the cost of capital to companies, which is soon after passed on to consumers in the form of higher prices for goods and services. Second, in some cases, economic transactions that are for the good of society will not occur because investors will demand a return that exceeds the economic return on the investment. That which the economists sometimes refer to as 'allocative efficiency' will suffer.

All of this even before we give serious consideration to reputation which is where I wish to maintain my focus in my comments today.

What is the risk to business with respect to its reputation with regulators and law enforcement? Well, we are in an era where law enforcement is being pushed to weed out evil perpetrators of corporate crime and go to great lengths to ensure there is a genuine risk of investigation, prosecution and subsequent incarceration. Similar to how it was demanded that we mercilessly crucify those who drive with even a little alcohol in their system, corporate crime is no longer socially acceptable. This is the ultimate threat to corporate criminals. Their crimes will no longer be romanticized and they will be treated no better than the common thief. If I were addressing corporate criminals today, I would say, look over your shoulder, we are being given

everything we need to come after you.

What is the risk to business with respect to shareholders? The new global economy has permitted our capital markets to become quite efficient and now accommodates shareholders rapidly seeking out solid sound investments regardless of where they might be in the world. In our technological savvy world of today, we have seen that shareholders can remove their investment very quickly even faster than the time it takes to make the original investment. The point I wish to make here is that investors are now actively seeking out those companies that can demonstrate good social responsibility. It is not difficult to find Canadian investment companies that follow ethical principles including restrictions in such areas as investment in tobacco companies, military, and that follow progressive environmental practices and promote human rights. Another good example pertaining to the socially responsible investor can be found in the United Nations 'Principles for Responsible Investing' (<http://www.unpri.org>) that refers to an overall goal of "help integrate consideration of environmental, social and governance issues by institutional investors into investment decision-making and ownership practices, and thereby improve long-term returns to beneficiaries."

Finally, please consider the risk to business brought on by their very own employees. There are two aspects to this. Firstly, we have seen new legislation similar to that in Canada where corporate whistleblowers are not only encouraged to report financial crime, but should a senior manager of the company try to interfere, they may find that they face criminal charges of their own. Secondly, in some countries we are about to experience the retirement of our so called 'baby boomers' and this in turn is expected to cause an unprecedented demand for new employees. In short, the job market is about to become extremely competitive. Employees will be in the most opportune position whereby they get to choose which company they would like to work for. I suggest to you that employees will choose only the very best companies...companies which can guarantee they will go to great lengths to ensure their house is in order and that they manufacture only good products or services.... Lets face it – it must be getting more and more difficult to find people who really want to work for cigarette companies.

Conclusion

Law enforcement officers around the globe are being pushed to deliver and will be pursuing corporate criminals with great enthusiasm. Shareholders have started choosing their investments based on social responsibility and ethical leadership. Western countries are experiencing the end of the baby boom and employees will soon be in big demand and able to pick where they want to work – thereby reasonably expecting to choose only the most socially responsible companies. This will not include those companies involved in corporate crime! I assert to you today that the future does indeed look tougher for those employees, executives or companies who may get involved in corporate crime.

Corporate crime has finally become socially unacceptable.