TAB 13

Federation of Law Societies of Canada

Fédération des ordres professionnels de juristes du Canada

MEMORANDUM

FROM: Federation Executive

TO: Council of the Federation
Law society CEOs (for information)

DATE: September 14, 2015

SUBJECT: Anti-Money Laundering and Terrorist Financing Issues

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ACTION REQUIRED: **Discussion by Council**

ISSUE

1. There have been a number of developments on the anti-money laundering and terrorist financing landscape that raise issues of potential significance for the Federation and the law societies. These developments include the Supreme Court's decision upholding the Federation's challenge to the government's attempt to apply the regulations under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (the "Act") to members of the legal profession, amendments to those regulations, and the recent report from the Department of Finance on money-laundering and terrorist financing risks with its statement that the government intends to introduce new provisions in the regulations to cover lawyers and Quebec notaries. Another development is the upcoming review of Canada's anti-money laundering and terrorist financing measures by the international Financial Action Task Force (the "FATF"). This memorandum describes the developments and discusses the issues arising for Council's consideration.

BACKGROUND

2. Members of the legal profession are required to abide by law society rules and regulations aimed at preventing them from unwittingly assisting clients with money laundering or terrorist financing activities. The law society rules and regulations are based on two model rules developed by a committee of the Federation comprised of Council and law society representatives. The first, the "no cash" rule, was approved by Council of the Federation in 2004 and prevents lawyers and Quebec notaries from accepting cash of $7,500 or more in relation to a single client file. The "client

identification and verification" model rule, approved in 2008, requires members of the profession to undertake due diligence procedures very similar to those contained in the federal regulations.

3. The model rules were developed against the backdrop of the attempt by the federal government to subject members of the legal profession to the Act and accompanying regulations. The government first sought to apply its anti-money laundering and terrorist financing legislation to lawyers and Quebec notaries in 2001 with the introduction of "suspicious transaction" reporting requirements. The Federation and several law societies launched a challenge to these provisions on the grounds that they would interfere with the representation of clients and would force legal counsel to breach solicitor-client privilege. The initial proceedings ultimately resulted in interlocutory injunctions precluding the application of the Act and regulations to members of the legal profession.

4. Recognizing the importance of fighting money laundering and terrorist financing activities, the Federation worked with the law societies to develop the no-cash model rule. Subsequent to its adoption the rule was recognized by the government as an effective alternative to the suspicious transaction reporting requirement. In 2006, the government enacted an amendment to the Act exempting members of the legal profession from this requirement.

5. The client identification and verification rules were developed in part in response to new government regulations purporting to impose client identification requirements on members of the legal profession. The rules require lawyers and Quebec notaries to undertake a number of client verification steps that are very similar to those in the federal regulations.

6. Although there have been amendments to the regulations in recent years, and further amendments have recently been proposed, there has been no review of the content of the rules since they were implemented by all law societies.

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7. In spite of the adoption and implementation of comprehensive client identification and verification rules and regulations by the law societies, the federal government persisted in its attempt to apply similar obligations in the legislation and regulations to lawyers and Quebec notaries. This led to renewal in 2011 of the legal proceedings between the Federation and the government. The Federation's constitutional challenge was upheld by both the British Columbia Supreme Court and the British Columbia Court of Appeal leading the government to appeal to the Supreme Court of Canada. In February 2015, the Supreme Court upheld the Federation's challenge finding that the Act and regulations, as applied to members of the legal profession, breached both sections 7 and 8 of the Charter and undermined the lawyer's duty of commitment to the client's cause.

8. In reaching its decision, the Court recognized the regulatory scheme put in place by law societies to prevent lawyers and Quebec notaries from unwittingly assisting in money laundering and terrorist financing activities. While noting that law society rules and regulations are not determinative of what should be in the federal regulations they

do support a finding that the regulations imposed obligations beyond what is required for ethical and effective client representation.

9. The decision of the Court did not preclude the possibility that the government could impose obligations on members of the legal profession that would be constitutionally compliant and the government has recently indicated that it plans to do so.

AMENDMENTS TO THE PROCEEDS OF CRIME (MONEY LAUNDERING) AND TERRORIST FINANCING REGULATIONS

10. Since adoption of the model rules, the government has made a number of amendments to the anti-money laundering and terrorist financing regulations. Additional proposed amendments were published in July 2015. While some amendments relate to the suspicious transaction reporting requirements from which legal counsel are exempt, the majority relate to the client verification (due diligence) provisions.

11. The model rules reflect the commitment of the law societies to regulate to minimize the risk of legal counsel becoming involved in money laundering or terrorist financing activities in a way that does not interfere inappropriately with the representation of their clients. As a result, while the Act and the regulations were influential in the development of the model rules, the rules do not mirror the federal statute or regulations. Where, for example, the Act requires those covered by it to report suspicious financial transactions to the government, the no-cash rule prevents legal counsel from accepting large amounts of cash. The client identification and verification model rule tracks the federal regulations more closely, but it too does not adopt all of the provisions imposed by government's regime.

12. Despite the differences between the model rules and the regulations, the regulatory amendments and other developments on the anti-money laundering and terrorist financing landscape offer an opportunity to consider whether amendments to the model rules are warranted.

13. From a review of the amendments that have been enacted to date it is evident that some either involve or introduce requirements that that go beyond what is necessary for lawyers and Quebec notaries to provide services to their clients.. There are, however, a number of amendments and proposed amendments to provisions that the model rule on client identification also addresses, including changes to definitions, and the list of methods that can be used to verify the identity of clients.

REPORT ON INHERENT RISKS OF MONEY LAUNDERING AND TERRORIST FINANCING

14. In July 2015 the federal Department of Finance released a report entitled *Assessment of Inherent Risks of Money Laundering and Terrorist Financing in Canada* (the "Report"). The Report (available here) discusses risks and vulnerabilities for 27 sectors and financial products, but as noted in its Executive Summary, does not consider the mitigating effects of legislative or regulatory measures aimed at preventing money laundering and terrorist financing.

15. The risk assessment is based on an analysis of three factors, threats, inherent vulnerabilities and consequences, and also takes into account the likelihood of exploitation of the inherent vulnerabilities. The Report rates "domestic banks, corporations (especially private for-profit corporations), certain types of money services businesses and express trusts"[1] as the most vulnerable, presenting a very high risk of money laundering and terrorist financing.

16. Legal professionals received a "high vulnerability rating" in the assessment of inherent vulnerability, and were found to be at high to very high risk of exposure to scenarios with a risk of money laundering due to the nature of the services they provide. Mortgage fraud is specifically identified as one of nine activities that pose a high threat and real estate transactions in general are noted as providing many opportunities for the witting or unwitting involvement of members of the legal profession in money laundering. The Report also suggests that members of the legal profession "may be used as intermediaries to put distance between criminal activities and the proceeds generated by these activities, and therefore to hide the source and true beneficial owners of such funds, often through complex corporate or trust structures formed with the assistance of legal professionals."[2]

17. One of the goals of the Report is to assist those entities and professions with reporting obligations under the Act in assessing and mitigating risks. While the Supreme Court struck down the reporting obligations of members of the legal profession, as discussed above law societies are actively regulating to limit the risks of lawyers and Quebec notaries becoming involved in money laundering and terrorist financing. Information in the Report on the risks faced by legal professionals may be relevant for these regulatory efforts.

18. The Report is perhaps most significant for a footnote indicating that the government will renew its attempt to bring members of the legal profession within the Act's ambit. Footnote 31 reads

> The provisions of the PCMLTFA that apply to the legal profession are effectively inoperative as a result of court decisions and related injunctions. Following a February 13, 2015 Supreme Court of Canada ruling, the Government of Canada is revisiting these provisions and intends to bring forward new provisions for the legal profession that would be constitutionally compliant.

19. No details on the content of provisions covering members of the legal profession are included in the Report.

FATF MUTUAL EVALUATION OF CANADA

20. The FATF is an international organization established in 1989 that sets standards for effectively combating money laundering and terrorist financing. In addition to specific recommendations (most recently revised in 2012) the FATF issues guidance on compliance and best practices. Canada has been a member of the FATF since 1990 and, as a member, is subject to a system of periodic mutual evaluations of

[1] *Assessment of Inherent Risks of Money Laundering and Terrorist Financing in Canada*, page 8.
[2] Ibid, page 52.

implementation of the FATF standards and the overall effectiveness of the anti-money laundering and terrorist financing regime.

21. In the past, the government has suggested that to meet the FATF standards, members of the legal profession must be included within the scope of the government's regime for combatting money laundering and terrorist financing. Consistent with this assertion, the last mutual evaluation report for Canada, released in 2008, found Canada non-compliant with certain standards due to the failure to include legal counsel within the scope of the Act and its regulations. A follow-up report issued in 2014 refers to the introduction in 2008 of amendments to the client due diligence and record keeping requirements to remedy this deficiency, but notes that they are inoperative due to the court decisions.

22. The next mutual evaluation of Canada is scheduled for October and November of this year, with the findings likely to be released in 2016. It is expected that the government will be motivated to demonstrate compliance with the FATF standards wherever possible. It is important to understand the government's announced intention to once again try to bring legal counsel within the scope of the Act in this international context.

SUMMARY OF ISSUES

23. The changes to the anti-money laundering and terrorist financing landscape outlined in this memorandum raise a number of issues for Council's consideration including some related to the model rules and others related to the government's apparent intention to introduce new legislative measures for legal counsel.

24. As already noted, the no-cash and client identification and verification rules have not been reviewed since their adoption. In light of the actual and proposed amendments to the federal regulations and the specter of new federal provisions for members of the legal profession, a comprehensive review may be advisable. The government's amended regulations and its risk assessment report could inform a review as could guidance from the FATF and the experience of the law societies in enforcing the rules.

25. The prospect of new federal legislation to bring the legal profession within the scope of the government's anti-money laundering and terrorist financing regime suggests the need to develop a comprehensive strategy in response. Such a strategy would need to include policy, government relations, communications and stakeholder engagement issues.

26. The appropriate mechanism for addressing all of these issues is another matter for consideration. The Federation's response to the government's initial attempts to include lawyers and Quebec notaries in its legislative regime, including the development of the model rules, was managed by a Federation committee that included members of Council, representatives of law societies and senior staff. The recently concluded litigation with the federal government was managed by a special committee comprised of the Federation Executive and representatives of the Law Society of Upper Canada and the Barreau du Québec.

27. Over the years the Federation has addressed other issues through special task forces, ad hoc committees and informal working groups. Material prepared for the issues

management discussion at the June 2015 Council meeting canvassed an array of possible approaches to developing positions on different policy matters and may be of interest in considering an appropriate mechanism for considering the anti-money laundering and terrorist finance issues set out above. A copy of the memorandum is available **here.**

QUESTIONS FOR DISCUSSION

28. In preparation for the discussion of these matters, Council members may wish to consider the following questions:

- How should the Federation respond to the changing anti-money laundering and terrorist financing landscape?
- Is consideration of the issues raised by the changing landscape of strategic importance?
- If the issues are of strategic importance, what priority should addressing them be accorded?
- What are the possible mechanisms through which to address the issues?