TAB 9

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 Presidents and CEOs (for information)

DATE: December 3, 2015

SUBJECT: Anti-Money Laundering and Terrorist Financing Issues

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ACTION REQUIRED: **Discussion by Council**

ISSUE

The implications of developments on the anti-money laundering and terrorist financing landscape and how the Federation might respond to these developments.

BACKGROUND

1. During the past year 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 the federal regulations;
- a recent report from the Department of Finance on money-laundering and terrorist financing risks in which the department indicates that the government intends to introduce new provisions in the regulations to cover lawyers and Quebec notaries; and
- the recently conducted review of Canada's anti-money laundering and terrorist financing measures by the international Financial Action Task Force (the "FATF").

2. Details of these developments are set out in the report to Council provided in advance of Council's last meeting (Appendix "A").

Update on FATF Assessment

3. Since the last memorandum to Council, assessors from the FATF have conducted their evaluation of the anti-money laundering and terrorist financing regime in Canada. The focus of that evaluation was not on the rules and regulations in place, but rather on their effectiveness. Following an opportunity for the government to comment on the draft assessment, the report will be presented to the FATF Plenary for approval in the summer of 2016.

4. In advance of the assessment, conducted from November 3-20, 2015, the Department of Finance identified organizations and other stakeholders with which the assessors met privately. Shortly before the assessment period, we learned that the Law Society of British Columbia had been invited to meet with the assessors to provide information in relation to the legal profession. In light of the national dimension of this issue, the LSBC suggested that the assessors speak to representatives of the Federation. At the request of the Executive, Federation CEO Jonathan Herman, and Senior Director, Regulatory and Public Affairs, Frederica Wilson, met with the assessors on November 18, 2015. Past President Thomas Conway was to have led the Federation in this meeting, but an urgent client matter prevented him from attending.

5. The Federation representatives provided the assessors with information on the law society rules and regulations in place across Canada. Using the material put before the courts in the Federation's case against the federal government, they also gave a general outline of the range of methods used by law societies to monitor compliance by members of the legal profession. The FATF assessors asked a number of questions about enforcement, including whether law societies take account of the relative risks that may be posed in different contexts. The assessors also inquired about statistics on enforcement, prosecutions and sanctions. They were informed that we do not currently collect such statistics.

6. It was evident from the questions posed by the assessors that they remain concerned that the existing regulatory scheme in Canada contains gaps in the oversight of lawyers, specifically when members of the legal profession are doing work other than traditional legal work. They were also interested in more detailed information on enforcement of the existing rules and regulations.

ISSUES

Review of Model Rules

7. The law society rules and regulations designed to prevent members of the legal profession from becoming involved in money-laundering or terrorist financing are based on two model rules developed by a committee of the Federation comprised of Council and law society representatives. The "no-cash" and "client identification and verification" rules have not been reviewed since they were approved and implemented by the law societies. In that time, the federal regulations have been amended a number of times and more amendments are anticipated in the near future. In addition, since the development of the model rules there has been an increased focus on the role of risk

assessments in preventing money laundering and terrorist financing. In the circumstances, a review of the model rules may be warranted. A review would also provide an opportunity to consider whether there would be merit in developing guidance on enforcement of the rules.

Responding to potential new regulations

8. In February 2015, the Supreme Court upheld the Federation's constitutional challenge to the application of the federal regulations to members of the legal profession. While concluding that the federal regulations interfered with the duty of commitment to the client's cause owed by lawyers to their clients, the Court did not preclude the possibility that the government could impose obligations on members of the legal profession that would be constitutionally compliant. In a report on the risks of money-laundering and terrorist financing released in July 2015, the government indicated that it plans to introduce new regulations to cover the legal profession.

9. 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 a pressing need to develop a comprehensive strategy in response. Such a strategy would need to address policy, government relations, communications and stakeholder engagement issues.

Enforcement Experience

10. As noted above, the FATF assessors were interested in statistical data on enforcement, prosecutions and sanctions related to the law society rules and regulations. Such data is not currently collected centrally and may not be readily available. Ad hoc information received from the LSBC and the Law Society of Upper Canada raises questions about how different law societies enforce the rules and prosecute lawyers found to be in breach. There may be merit in reviewing the collective experience with enforcement of the rules. Such a review might yield information on the effectiveness of the regime put in place by the law societies to fight money laundering and terrorist financing.

ADDRESSING THE ISSUES - CONSIDERATIONS

Strategic Priority and Timing

11. One of the first issues Council will need to consider is the relative strategic importance of reviewing the model rules and their enforcement, and of developing a comprehensive strategy for responding to any new government initiative to bring lawyers and Quebec notaries within the scope of the federal anti-money laundering and terrorist financing regime. This issue also involves considerations of timing.

12. A number of factors may be relevant to Council's consideration of this issue including the ongoing governance review and the fact that Council has not yet begun the process of preparing a new strategic plan. The FATF evaluation of Canada currently underway is another element to consider, as is uncertainty over when the government might move to introduce new regulations covering the legal profession.

13. Beginning work on some or all of the issues discussed above before the completion of the governance review process may present challenges. With questions about the appropriate mechanisms and processes for addressing new policy issues not yet decided, the appropriate model for tackling these issues may not be clear. The governance review process is pointing to the formal establishment of a CEOs Forum and a Presidents' Forum, both of which are intended to provide input and advice to the Council's deliberation on matters such as these.

14. Deciding the strategic priority of these issues in isolation also carries risks. Typically the strategic planning process involves ranking a number of possible priorities based on the mission of the organization and other factors. Available resources are relevant in this planning process and resource allocations are based on the choices Council makes about the relative strategic importance of the different activities or initiatives under consideration. The comparative nature of this exercise ensures that Council members are aware of the impact of the choices they make. Deciding whether to allocate resources to the anti-money laundering issues outside the strategic planning exercise contemplated for next year would mean that Council would not have the value of the usual comparative process.

15. Other factors may, however, argue in favour of deciding to address the anti-money laundering issues now. As noted above, the FATF mutual evaluation of Canada is currently under way. Proceeding now to review the model rules, gather information on their enforcement, and consider whether changes should be made to strengthen the anti-money laundering regime put in place by the law societies might afford an opportunity to address some of the apparent concerns of the assessors. This might improve the assessment as it pertains to the legal profession and, while perhaps not sufficient to dissuade the government from introducing new legislation or regulations affecting the legal profession, would also portray the law societies own anti-money laundering regime in the best possible light.

16. The threat of new government legislative action is another reason to consider tackling these issues now rather than waiting the outcome of the governance review and future strategic planning. As noted above, a comprehensive strategy will need to be developed to respond to attempts by the government to include members of the legal profession within the ambit of the federal anti-money laundering and terrorist financing legislation and regulations. Such a strategy will need to address issues of policy, government relations, communications, stakeholder relations and potentially litigation. Developing such a strategy will take time to develop. With no information on the timing of potential government action it may be prudent to begin that work as soon as possible. There is a risk that the government's policy rationale for introducing new legislation will be strengthened by the absence of a national, coordinated approach by the law societies, particularly on the enforcement and demonstrable effectiveness of the law societies' anti-money laundering rules.

Process and Mandate

17. If the Council decides to move forward to consider some or all of the anti-money laundering issues it will also have to decide on the appropriate process or processes for doing so. Over the years the Federation has used a number of different vehicles to tackle important policy and other issues. These have included special task forces (e.g. the Task Force on the Canadian Common Law Degree), special committees (e.g. the

Special Litigation committee established to oversee the litigation with the federal government), and ad hoc committees (e.g. the Ad Hoc Committee on Approval of New Canadian Law Degree Programs). Each of these vehicles has had a specific, time-limited mandate. Another approach would be to establish a standing committee with a permanent presence.

18. A number of factors will be important to consider in selecting the preferred process, the breadth and nature of issues to be addressed and the required skill sets to do so key amongst them. Timing is another important factor to consider.

19. A single body with a broad mandate to address all of the issues – both those involving a review of the existing law society anti-money laundering rules and the development of a strategy to respond to a potential new government legislative initiative – would have an important advantage. The issues are clearly linked and mandating a task force or special committee to address the full set of issues would ensure a coordinated, consistent approach. This might prove the simplest way to guarantee, for example, that the review of the rules takes into account the overall strategy for responding to any proposed legislative changes.

20. It may prove challenging, however, to ensure that such a body is both broadly representative and populated with people with the required skills and knowledge. Some of the issues, for example those relating to enforcement of the rules, are quite operational in nature. Law society CEOs and other senior staff may be best placed to address such operational matters. Other issues will involve matters of policy and government relations that will require broadly representative political leadership. The different nature of some of the questions to be addressed may argue in favour of establishing different processes to address different aspects of the over all issues. Another possibility would be to charge a single committee or task force with the overall mandate for handling these issues, relying on expert advice and guidance as appropriate to address specific aspects.

21. A final factor to be weighed is that of timing. With the FATF assessment under way now, there may be merit in moving quickly to consider matters related to the effectiveness and enforcement of the existing law society anti-money laundering rules and regulations. A committee or other body with a narrower mandate comprised of people with specialized expertise may be the most effective process if Council concludes that some or all of this work should be done before the assessment of Canada has been finalized. Should Council adopt such an approach, it could, of course, set up at the same time a process to address the broader issues, but with a later deadline for completion of that work. Another option would be to establish a single task force or special committee with a broad mandate, but with a direction to first address the narrow issues related to the law society rules and regulations.

Resources

22. Resource implications are another relevant factor for Council to consider in determining whether addressing the anti-money laundering and terrorist financing issues is a strategic priority for the Federation and if so what vehicle or vehicles to use to do so.

23. Any committee or task force will require the assignment of Federation staff to support the work. The nature of the different issues will have an impact on the demands on staff time, but even a committee with a narrower mandate to review the effectiveness

and enforcement of the money-laundering rules and regulations will require some investment of staff resources. The more extensive the mandate the greater the likely demand for assistance. Undertaking a new initiative, whether confined to a review of the rules or with a broader mandate, may reduce the availability of staff support for other Federation projects and initiatives.

24. The Federation is increasing its complement of policy counsel to keep up with the array of matters currently expected to be dealt with by the Federation. One new junior counsel begins work on December 7, 2015 and the process for hiring a senior policy counsel well underway. These new hires will bring to three the number of full time policy counsel. With the Senior Director, Regulatory and Public Affairs and the Director, Regulatory Affairs also carrying full loads the Federation's professional staff resources will now be considerably more robust. It should be noted, however, that the full effect of the increase in policy staff won't be felt until early July 2016 when our existing policy counsel returns from maternity leave. The CEO is currently working with the policy team to ensure these resources are efficiently deployed in accordance with the Federation's needs.

OPTIONS FOR DISCUSSION

25. The following are possible options for Council to consider in light of the issues canvassed above:

Strategic Priority and Timing

QUESTION: Is this issue a strategic priority and if so, when should it be acted upon?

(a) Postpone consideration of the relative strategic priority of the anti-money laundering issues discussed in this memo and in the previous memo to Council attached as Appendix "A" pending completion of the governance review and strategic planning processes or pending the opportunity for the CEOs Forum (next scheduled for January 25, 2016) and the Presidents' Forum (none yet scheduled before March 2016) to provide input and advice;

(b) Move forward now to address the all of issues, beginning by identifying an appropriate process and terms of reference;

(c) Move forward now on the issues related to the Model Rules and their enforcement while postponing development of a comprehensive strategy to respond to a possible new legislative initiative by the federal government;

(d) Move forward now to develop a comprehensive strategy while postponing specific consideration of the issues related to the Model Rules; or

(e) Move forward now to gather intelligence about the government's legislative intentions in order to assess the relative urgency in dealing with the issues.

Process

QUESTION: If this issue is a strategic priority, what mechanism(s) should be developed to deal with it?

(a) Establish a task force or special committee with a broad mandate and the required broad representation to address all of the issues discussed above and in Appendix "A";

(b) Establish a task force or special committee with a broad mandate to address all of the issues, but with a direction to first address those related to the law societies anti-money laundering and terrorist financing regime;

(c) Establish a committee with a narrow mandate to review the content, effectiveness and enforcement of the law society anti-money laundering rules and regulations and defer a decision on whether and when to address the broader issues; or

(d) Establish different processes for addressing the broader policy and government relations issues and those involving a review of the law society rules and regulations.

APPENDIX "A"

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.

CANADA (ATTORNEY GENERAL) v. FEDERATION OF LAW SOCIETIES OF CANADA

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.

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

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 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?