

Memo

To: FLSC AMLTF WORKING GROUP – Phase 2 - CIV Working Group
From: Jeanette McPhee, CFO and Director of Trust Regulation, Law Society of British Columbia
Date: October 25, 2019
Re: Source of Funds (or Money) and Wealth

INTRODUCTION

This memo is to outline some of the issues about the source of funds (or money) to determine if further rule changes, code changes, and/or guidance should be considered to clarify the legal profession's obligations regarding obtaining and recording the "Source of Funds".

FEDERATION OF LAW SOCIETIES OF CANADA (FLSC)

The FLSC approved enhanced AMLTF model rules in October 2018 which are being implemented at a provincial level across Canada.

An important revision was to include in the Client Identification and Verification (CIV) rules an obligation to obtain and record the client's source of funds, as follows:

Requirement to Verify Client Identity

Rule 6. (1) When a lawyer is engaged in or gives instructions in respect of any of the activities described in section 4, the lawyer must

(a) obtain from the client and record, with the applicable date, information about the source of funds described in section 4, and

(b) verify the identity of the client, including the individual(s) described in paragraph 3(2)(d), and, where appropriate, the third party using the documents or information described in subsection (6).¹

¹ <https://flsc.ca/wp-content/uploads/2019/04/Client-ID.pdf>

SOURCE OF FUNDS OBSERVATIONS

Through our discussions and as evidenced in our findings in compliance audits and investigations, the meaning behind the term source of funds and the requirements around it, are not always clear and can be interpreted in many different ways.

Specifically, economic origin may not be considered when obtaining the source of funds. A common example is that the source of funds can be interpreted as ‘form of funds’, or the type of financial instrument, such as “cheque” or “bank draft”, which is often recorded as the source of funds. Other interpretations is that the source of funds is the person who has provided the funds, such as “Client - John Doe”. Another common example that is recorded is the financial institution who issued the cheque or electronic funds transfer, such as “Royal Bank”.

Another issue that should be considered is that the rule requirement is to “obtain and record the source of funds”, which can be interpreted literally. This would mean that the information is obtained and recorded, but there would not be further consideration to determine if the source of the funds is reasonable and proportionate to the profile of the client. If this requirement is not explicit in the rules, it can be very difficult to enforce this expected requirement.

One additional point is that there should be clarification of the various terms that can be used, as source of funds is sometimes used interchangeably, with “source of money” and “source of wealth”.

THE FINANCIAL ACTION TASK FORCE (FATF) GUIDANCE

Source of funds and wealth is addressed in the FATF’s Guidance for a Risk-Based Approach for Legal Professionals, noting that it is important to obtain an understanding of the **source of funds and source of wealth** of the client, its owners and the purpose of the transaction.²

According to the FATF, source of funds and wealth are relevant to determining a client’s risk profile. The source of funds is the activity that generates the funds for a client (e.g. salary) and relates to the economic origin of the funds to be used in a transaction. Source of wealth describes the activities that have generated the total net worth of a client (e.g. ownership of a business, inheritance, or investments). Legal professionals should satisfy themselves that adequate information is available to assess a client’s source of funds and source of wealth as legitimate with a degree of certainty that is reasonable and proportionate to the risk profile of the client.³

² <https://www.fatf-gafi.org/media/fatf/documents/reports/Risk-Based-Approach-Legal-Professionals.pdf>

³ <https://www.fatf-gafi.org/media/fatf/documents/reports/Risk-Based-Approach-Legal-Professionals.pdf>

RECENT GUIDANCE FROM LAW SOCIETIES

There is some guidance that has been developed to outline the meaning and requirements about obtaining and recording the source of funds, which follows the FATF's interpretation of what source of funds means.

1. Federation of Law Societies of Canada

The Federation's website for its "Guidance to the Legal Profession" addresses the source of funds requirement, with an excerpt noted below:

Information on the Source of Client Funds

In addition to verifying clients' identities when engaging in, or giving instructions in respect of, receiving, paying or transferring funds on behalf of a client, legal professionals are also required to obtain information about the source of the funds relating to the retainer. This requirement applies to both individual and organizational clients.

The rule requires you to inquire about the expected source and origins of the funds related to the legal services to be provided. This may be apparent from the information obtained from the client for the retainer. In general, you should make sufficient inquiries to assess whether there is anything that suggests the proposed transaction is inconsistent with the client's apparent means, and the circumstances of the transaction.

In making this assessment, depending on the circumstances, you may wish to consider questions such as:

- *Is someone other than the client providing information about the source of funds?*
- *Is the disclosed source consistent with the knowledge about the client's profile and activity?*
- *Is there anything unusual about the source of the funds in the context of the transaction?*

For record-keeping purposes, you should also retain supporting documents that relate to how you determined the source of funds.⁴

2. Law Society of British Columbia

The Fall 20129 Law Society of British Columbia Benchers Bulletin provided guidance on inquiries about the source of funds (or money) and the source of wealth, with an excerpt noted below:

⁴ <https://flsc.ca/wp-content/uploads/2019/02/GuidanceLegalProfessionEN.pdf>

What does “source of money” mean in client verification?

For the purposes of client verification Rule 3-102(1)(a), a client’s source of money is directly related to the economic origin of the money. The money is most likely to be received from a bank account regardless of the form in which it is received (e.g. cheque, e-transfer). However, in addition to a bank account or other source (e.g. cash), the client’s source of money means the name of the payer and the activity or action that generated the client’s money for the financial transaction for which the lawyer is providing legal services. Some examples are the client’s salary, a bank loan, a share sale, the sale of an insurance policy, payment from a trust fund and payment from a third party.

At a minimum, the lawyer must record for the purposes of Rule 3-102(1)(a):

- information obtained from the client about the activity or action that generated the client’s money (e.g., salary, bank loan, inheritance, court order, sale agreement, settlement funds);*
- the economic origin of the money (e.g., credit union account, bank account, Canada Post money order, credit card charge, cash);*
- the date the money was received; and*
- the source from whom the money was received (i.e., the payer: the client or name and relationship of the source to the client).*

It would be prudent to make copies of any supporting documents (e.g., bank statement, court order, sale agreement) obtained regarding the source of money and retain them. Of course, you are required to obtain and retain information and documents used for verification of a client’s identity (Rule 3-107).

FURTHER CONSIDERATION

The AMLTF Working Group needs to ensure that the legal profession has a good understanding of the term and obligations for the “source of funds” and ensure that the rules in place are clear and law societies are able to effectively monitor and enforce these rules and obligations.

Some issues to consider are noted below:

- Should there be further changes to the model rules (or the model code) to include “economic origin” and additional information to clarify the meaning of the term, “source of funds” and “source of wealth”?
- What does “obtain and record” mean? Should there be further changes to the model rules (or the model code) to provide specifics about what steps the legal professional should be taking when assessing the source of funds against the client profile?
- Should there be requirements for legal professionals to document the steps they have taken to assess the risk and source of funds? How should this work be evidenced by the legal professional?

- Should there be additional guidance documents developed on the meaning of source of funds?
- When does determining the source of funds move to going to the next step fo determining the source of wealth?
- What are the requirements under Fintrac for other reporting entities? Should we mirror this or go beyond?
- Should there be a form produced to clarify what type of information should be obtained on source of funds, and source of wealth?
- Fintrac requires a “Risk Assessment System” for reporting entities. Should obtaining and recording the source of funds and/or wealth be incorporated into a risk assessment system for legal professionals?