THE CANADIAN BAR ASSOCIATION
L'ASSOCIATION DU BARREAU CANADIEN

April 3, 2018

Via email: fwilson@flsc.ca

Frederica Wilson
Executive Director, Policy and Public Affairs and Deputy CEO
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Dear Ms. Wilson:

Re: Proposed amendments to Model Rules on Anti-Money Laundering and Terrorist Financing

The Canadian Bar Association's Working Group on Anti-Money Laundering Model Rules (CBA Working Group) offers comments on amendments to the Model Rules on "No Cash" and "Client Identification and Verification" and a new Model Rule on "Trust Accounting" proposed in the Consultation Report of the Federation of Law Societies of Canada Anti-Money Laundering and Terrorist Financing Working Group.[1]

The CBA is a national association of 36,000 lawyers, Québec notaries, law teachers and students, with a mandate to promote improvements in the law and the administration of justice. The CBA Working Group is led by the CBA Ethics Subcommittee and comprises a cross-section of members drawn from diverse regions and areas of expertise. We particularly recognize the contribution of the Ontario Bar Association (OBA), whose submission to the Law Society of Ontario is included as Appendix 1.

The FLSC is familiar with the CBA's long history of advocacy on public policy initiatives about proceeds of crime (money laundering) and terrorist financing. The CBA has engaged with Parliamentarians and officials to argue that proposed laws respect the independence of the bar and protect solicitor-client privilege, and intervened in the court challenge initiated by the FLSC when

[1] See: Consultation Report, Anti-Money Laundering and Terrorist Financing Working Group, October 2, 2017.

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lawyers were included in the government scheme.[2] We appreciate that the FLSC Model Rules on Money Laundering and Terrorist Financing are not only intended to guide legal professionals to avoid being unwittingly used by their clients to help with these activities, but also to ensure that this guidance is applied in a regulatory context that maintains the independence of the bar and protects a lawyer's duty of confidentiality to their clients.

New Model Rule on Trust Accounting

Section 1 of the proposed new Model Rule would restrict the use of trust accounts to situations where the lawyer or law firm is providing legal services. The Consultation Report states that this requirement would be consistent with restrictive approaches adopted by law societies in British Columbia, Ontario and Quebec.

However, other law societies do permit their members to use trust accounts while acting in a representational capacity and have rules to support this practice. In Manitoba, for example, where a lawyer receives fiduciary property while acting in a representative capacity and places that property in a trust account, they must comply with all of the trust accounting rules as if the fiduciary property were trust money.[3] There are also specific obligations where a lawyer acting in a representative capacity does not put fiduciary property in a trust account.[4] To avoid the situation where some law societies may not be in a position to adopt the proposed new Model Rule, we recommend that the affected law societies implement a rule similar to the above-referenced Manitoba rule or that section 1 be revised as follows:

> Rule 1
>
> All deposits or transfers into, and withdrawals or transfers from a trust account, must be directly related to an underlying transaction or matter for which the lawyer or the lawyer's law firm is providing legal services, or to the provision of representative capacity services, where the fiduciary property will be placed into a trust account.

Proposed Rule 2 requires no changes as it would be broad enough to cover money held in trust in a representative capacity.

We find Commentary 1 to be confusing. We believe the obligation to avoid "mere banking services" is the essence of the commentary, and recommend it be stated as a rule.

> Rule 3
>
> The lawyer must ensure that a trust account is not used for mere banking purposes.

A commensurate adjustment to the definition of professional fees, currently found in the Model Rule on Client Identification and Verification, may be required.

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2 See: *Canada (Attorney General) v. Federation of Law Societies of Canada* [2015] 1 S.C.R. 401. Recent submissions include: CBA submission to Finance Canada on draft regulations (April 2012), CBA submission to Senate Committee on Banking, Trade and Commerce (April 2012).

3 See Rule 5-43(1.1).

4 See Rule 5-43(1.2)

Proposed Amendments to No Cash Rule

Following on the comments above, it may be prudent to amend the No Cash Model Rule to include cash received by a lawyer acting in a representative capacity. For example:

> 1. A lawyer shall not receive or accept from a person, cash in an aggregate amount greater than $7500 Canadian dollars in respect of any one client matter or transaction or in respect of money received while acting in a representative capacity where the fiduciary property will be placed into a trust account.
>
> 3. Paragraph 1 applies when a lawyer engages on behalf of a client or gives instructions on behalf of a client or acts in a representative capacity where the fiduciary property will be placed into a trust account, in respect of the following activities: …
>
> 4. Despite paragraph 3, paragraph 1 does not apply when the lawyer receives cash in connection with the provision of legal services by the lawyer or the lawyer's firm or the provision of representative capacity services where the fiduciary property has been placed into a trust account: …

Proposed Amendments to the Model Rule on Client Identification and Verification

Section 4

No amendment to section 4 has been proposed. The CBA Working Group believes the exception in section 4 for electronic funds transfer (EFT) causes confusion. We understand the reason for the exception is a presumption that there are additional safeguards within financial institutions for EFTs. However, there is a lack of clarity whether this applies to two-way EFT transactions only or also captures one-way EFT transactions (e.g. funds received by EFT and paid out by bank draft, or vice versa). We question why other types of transactions are not included, such as certified cheques when similar safeguards are in place.

Subsection 6(2)

Subsection 6(2) lists examples of documents required to verify client identification. The Consultation Report states the proposed amendments are intended to mirror corresponding changes to federal regulations.

The OBA submission points to the access-to-justice challenges in requiring face-to-face methods of verification. There are other practical issues with this approach when a client is unable to be present at the time of a transaction. Section 7 allows the use of an agent when a client is outside of Canada. However, the proposed amendments do not address the situation when a client is present elsewhere in Canada. We believe the current provisions on clients present elsewhere in Canada offer a workable solution and should be retained.

The simplest method proposed for client identification and verification – viewing original government-issued identification – retains some vulnerability.[5] The second method proposed – obtaining a Canadian credit report – is costly, and the result is not robust. While credit grantors

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[5] See LawPRO reports on the prevalence of false identification; online (https://bit.ly/2DWKgWv), media reports on novelty identification, online (https://bit.ly/2GbVIiW), and an example of a website selling false passports, online (https://bit.ly/2GugLAQ).

(financial institutions) may have the infrastructure in place to obtain credit information, this is not the case for law firms. If this option remains, we recommend the rules permit the use of an agent (such as Dye & Durham). This is an option identified in the Consultation Report, but not in the proposed amendments to the Rule. More generally, a registry run by an appropriate third party, similar to "e-reg", may provide a more reliable, and practical option for the profession.

The requirement in subsection 6(2) that information "must not include an electronic image of a document" creates some inconsistencies. For example, a hydro bill satisfies one of the criteria in subparagraph 6(2)(a)(iii). The criteria permit an email "copy" of the hydro bill, but not a printout from an online hydro account. This is an example of a technologically-embedded and dated requirement. Further, the reference in the subparagraph to "a reliable source" lacks clarity. If this paragraph remains, we recommend adding commentary on what constitutes a reliable source.

The method proposed in subparagraph 6(2)(a)(iv) – written confirmation that verification has already been done by an affiliated firm – offers an advantage to lawyers in large firms. However, we encourage robust options that offer a level playing field to all lawyers, making it easier for lawyers to enter into agency relationships with lawyers at other firms, rather than law firms in affiliation.

Generally, the CBA Working Group believes the Model Rules should adopt a more modern approach, and we reiterate the comments in the OBA submission on the advisability of principles-based, outcomes-focused regulation.

A Competition Bureau study recommends that regulatory approaches be technology-neutral and device-agnostic:

> Prescriptive rules regarding how a firm must comply with a regulation are often written with the technology of the day in mind. For example, consumers may still face instances where service providers require a 'wet' signature, verification of identification or collection of personal information in person or through a face-to-face conversation. These rules and policies may have made sense when transactions occurred in person at a branch, but the Internet and mobile computing have changed how consumers wish to consume services—and how providers provide them.[6]

The same study also encourages, to the extent possible, principles-based regulation:

> Policymakers should aim to create regulation based on expected outcomes rather than on strict rules of how to achieve those outcomes. A regulation that prescribes exactly how an identity must be verified, for instance, can potentially limit an innovative service from using new, more effective ways of verifying customer identity such as biometrics or remote identity verification through third-party sources. If this same regulation was based on the notion that the service provider must verify the identity of a customer using sufficiently robust means or demonstrated diligence, it could encourage innovation in the marketplace. Principles-based regulation has the added benefit of allowing regulators the flexibility to issue guidance and be more flexible in their approach to enforcement as technology changes.[7]

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6 *Technology-Led Innovation In The Canadian Financial Services Sector: A Market Study* (December 2017), at 20, online (https://bit.ly/2CS6VmX)

7 *Ibid.* Also referenced in the OBA submission.

Finance Canada has made similar comments that regulations should:

> Remain flexible and adaptive in an environment of rapid development and emerging technologies. Continuous progress towards more principles-based requirements could allow reporting entities to take a risk-based approach vis-à-vis new technologies. Such an approach to regulation would provide for a nimbler framework that would do a better job at leveraging technology solutions, which should ultimately enhance the effectiveness of the AML/ATF Regime.[8]

We encourage the FLSC to move towards a modern, risk-based approach, allowing lawyers to use methods for client identification and verification that they find reasonable, knowing their accountabilities, rather than entrenching technologically-bound and dated prescriptions.

Subsection 6(3)–(10), Section 10

The CBA Working Group supports robust practices for identifying and verifying the individual owners or representatives of client organizations. However, we question the effectiveness of the proposed amendments in subsections 6(3) through (10) and section 10.

i. No follow-up identification required

Subsection 6(13) states that a lawyer need not conduct any subsequent investigation once the initial requirements are completed, "unless they have doubts about the information that was used for that purpose". This appears to mean, for example, that the directors and shareholders of a corporation could change following the initial identification, and the lawyer would have no requirement to follow-up unless they learned of such changes. Arguably, this language does not trigger any follow-up (even if the lawyer suspects changes have occurred) as long as they don't have suspicions that the information provided at the time of identification was incorrect.

Subsection 6(6), on its face, appears to impose additional obligations in the event a lawyer is unable to identify a client organization and to confirm the identity of the individuals behind it. The requirement in paragraph 6(6)(b) to conduct "ongoing monitoring" in these situations imposes the same section 10 obligations applicable to all clients where section 4 is triggered. Section 10 is silent as to client identification and verification.

Given our understanding that the monitoring requirements in section 10 are intended to apply to all clients and not just those deemed high risk, paragraph 6(6)(b) appears to be redundant. If it is only intended to apply to high risk clients, that should be clarified.

Accordingly, we believe the proposed amendments are unlikely to be effective and might encourage would-be malefactors to hide behind opaque organizational structures. That will not be difficult, especially in the absence of federal and provincial rules regarding transparency of private company beneficial ownership.

In addition to legislative changes to improve transparency on corporate ownership, we believe this could also be partially remediated by adding a client identification provision to the monitoring requirement in section 10. This could take the form of a new paragraph 10(a)(iii), to the effect of "ensuring the currency of the lawyer's knowledge and records with respect to the client's identity, which may require repeating the measures conducted in section 6."

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8 Reviewing Canada's Anti-Money Laundering and Anti-Terrorist Financing Regime, February 7, 2018, online (https://bit.ly/2pIhZOl)

For consistency, we propose that this requirement be reflected in subsection 6(13), for example by adding the words ", including as to whether it remains current" at the end of the proposed addition to that paragraph.

ii. Meaning of 25 per cent owners

The CBA Working Group recommends the reference in paragraph 6(3)(b) to "all persons who own, directly or indirectly, 25 per cent or more of the organization or the shares of the organization" be clarified to indicate whether voting rights, equity or both are intended to be captured. Alternatively, the concept of "control" could be added in this paragraph, so the applicable words read "all persons who own or control, directly or indirectly…" This would accord with the reference to control in paragraph 6(3)(d).

The CBA Working Group also considered the potential relevance of the 10% shareholder rule under the *Income Tax Act*. A tax-free dividend may be paid from a lawyer's trust account if the recipient organization (corporation) owns at least 10% of the votes and equity of the payer organization (corporation), but establishing the identity of the recipient only comes into effect at 25%.

iii. Meaning of "ascertain the identity"

The CBA Working Group believes the requirement in paragraph 6(6)(a) – triggered when a lawyer is unable to identify individuals behind an organization – to "take reasonable measures to ascertain the identity of the most senior managing officer" requires context or instruction. For example, there is a difference between a requirement to ascertain identity and the subsection 6(3) requirement to "obtain" names and information. It is unclear if there is any additional or different requirement between obtaining names and information and ascertaining identity. We also recommend adding a paragraph in the Rule to provide examples ("includes but is not limited to") of reasonable measures.

Rules of professional conduct offer important guidance to lawyers on how to avoid practices that can unwittingly facilitate money laundering and terrorist financing. The CBA Working Group believes that these should be supplemented with accredited continuing professional development programs for the profession.

We thank the FLSC for considering these comments, and would welcome the opportunity to provide additional comments as work on this issue proceeds.

Sincerely,

(original letter signed by Tina Head for Darcia Senft)

Darcia Senft
Chair, CBA Ethics Subcommittee

Appendix 1: CBA - OBA Submission to Law Society of Ontario

Proposed Amendments to Anti-Money Laundering Model Rules

Date: February 23, 2018

Submitted to: Law Society of Ontario, Professional Regulation Committee

Submitted by: Ontario Bar Association

ONTARIO BAR ASSOCIATION
A Branch of the Canadian Bar Association

L'ASSOCIATION DU BARREAU DE L'ONTARIO
Une division de l'Association du Barreau canadien

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Introduction

The Ontario Bar Association ("**OBA**") is pleased to provide comments to the Law Society of Ontario's Professional Regulation Committee (the "**Committee**") on issues and concerns raised in the Law Society's Call for Comment on Proposed Amendments to Anti-Money Laundering ("**AML**") Model Rules (the "**Call for Comment**").

As stated in the Call for Comment, the Federation of Law Societies of Canada ("**FLSC**") has proposed amendments to the Model Rules and the Committee is seeking comments from the professions that would be taken into consideration in providing feedback to the FLSC.

The OBA

Established in 1907, the OBA is the largest legal advocacy organization in the province, representing more than 16,000 lawyers, judges, law professors and law students in Ontario. OBA members are on the frontlines of our justice system in every area of law and in every type of practice, and provide legal services to a broad range of clients in every region of the province. In addition to providing legal education for its members, the OBA is pleased to assist government, the Law Society, and other decision makers with dozens of policy initiatives each year – in the interests of the public, the profession, and the administration of justice.

This submission was primarily prepared by members of the OBA's Business Law Section, with input from members of the OBA's Sole, Small Firm and General Practice Section. Together, these sections comprise approximately 1500 lawyers and include members with significant experience advising clients on AML matters, in addition to their experience as practicing lawyers in both large and small-firm environments.

Overall Comments

OBA members participating in this submission are aware of the developments that the Law Society has indicated inform the current consultation:

(a) amendments to regulations under federal legislation (*the Proceeds of Crime (Money Laundering) and Terrorist Financing Act* ("**PCMLTFA**"));
(b) the Mutual Evaluation Report of the Financial Action Task Force ("**FATF"**); and,
(c) the possibility of a renewed effort by the federal government to extend the PCMLTFA to members of the legal profession.

However, an overall comment made by our members is that while the PCMLTFA regime is tailored to apply to certain entities (like banks, and other financial institutions) and the legal profession can look to it for guidance in developing AML rules, its provisions and some of its concepts cannot be directly applied to or adopted by lawyers and law firms without appropriate modification.

Indeed, in several instances, the proposed changes appear to be transplanted directly from another context, are not directly applicable to lawyers and lawyers may not be in an appropriate position to comply with the obligations set out within the regime.

A second overall comment from our members is that the proposed rules appear to be designed to set out areas of prohibited conduct, and aid in the prosecution and/or discipline process for individuals who do not comply with the rules. While the OBA supports appropriate measures that deter and penalize money laundering activities, the rules themselves do not provide any practical guidance to lawyers with respect to how to conduct themselves appropriately to avoid becoming involved in a money-laundering scheme. In our view, the next steps of the Committee involved in reviewing the proposed rule changes should include developing supports and training for Ontario lawyers on their obligations and practical means to incorporate those obligations into their day to day practice.

Client Identification and Verification

Section 4 – Exemption for Electronic Funds Transfer

While there is an exemption for electronic funds transfer under the rules, it is unclear why there is no similar exemption for certified cheques or bank drafts. In the view of our members, in the case of a bank draft, all of the same or similar verification elements are present and/or available. It is not clear what prevents the circumvention of this rule where a bank draft can be deposited and an electronic transfer used to transfer the same funds.

Section 6(2) – Examples of Independent Source Documents

Our members recognize the importance of appropriate client identification. However, there is a consensus among our members that the two methods permitted to verify the identity of an individual are dated, one is largely impractical, and neither method permits for new technologies that could be used by lawyers and law firms to appropriately identify clients.

The first method, using government-issued photo identification, requires the original document to be viewed by the lawyer in the presence of the client. In the view of our members, this rule should be adjusted to permit appropriate verification of identity but not require face-to-face methods. In the experience of our members, the in-person verification of government issued identification can, in certain cases, pose challenges for access to justice and available alternatives (such as the use of Notaries) are often themselves onerous for clients facing access concerns. Our members would welcome appropriate identification methods that can maintain confidence in the system, while providing reasonable alternatives for clients and practitioners.

The second method permits lawyers to refer to a Canadian credit file. Our members have indicated that identify verification in this manner is not as straightforward as the draft model rule would

purport. Law firms, generally speaking, do not have arrangements with the credit bureaus to obtain credit information; this is something that credit grantors (like banks) usually have in place. In addition, identity verification using this method is a resource and technology intensive process for which most law firms are not properly equipped. As such, while there is no surprise that the "credit bureau" method is permitted by the federal rules, it is not in keeping with regular business practices at law firms.

As stated more generally above, applying the requirements that are currently in place in the PCMLTFA regime for identity verification directly to lawyers and law firms is impractical. In our view, updated rules should account for new technologies that can be implemented to appropriately identify clients. Recently, the Competition Bureau released a report on *Technology Led Innovation in the Canadian Financial Services Sector*[1] which advocates for principles-based regulation, providing the following example:

> Policymakers should aim to create regulation based on expected outcomes rather than on strict rules of how to achieve those outcomes. A regulation that prescribes exactly how an identity must be verified, for instance, can potentially limit an innovative service from using new, more effective ways of verifying customer identity such as biometrics or remote identity verification through third-party sources. If this same regulation was based on the notion that the service provider must verify the identity of a customer using sufficiently robust means or demonstrated diligence, it could encourage innovation in the marketplace. Principles-based regulation has the added benefit of allowing regulators the flexibility to issue guidance and be more flexible in their approach to enforcement as technology changes.

Sections 6(3), (4) and (5) – Identifying Directors, Shareholders and Owners

In the view of our members, the requirements in sections 6(3), (4) and (5) with respect to beneficial ownership are, in general, onerous requirements that are very difficult to satisfy.

The FLSC Consultation paper sets out the view that, in the absence of a robust corporate registry system that includes beneficial ownership information, complying with this requirement may sometimes be difficult. In our view, in the absence of such a registry, compliance with respect to beneficial ownership is not reasonably possible. Compounding the issue for lawyers is the fact that financial regulators have restricted the information that lawyers can rely on to confirm beneficial ownership in such a way that, in our view, these requirements have become impractical. In order

[1] Competition Bureau, 2017 online at http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/04322.html.

to truly ascertain information on beneficial ownership, changes would be required to provincial and federal corporate legislation.

Similarly, monitoring beneficiaries of a trust (who are often children and generally quite mobile) requires more guidance than "lawyer shall take reasonable measures to confirm the accuracy of the information obtained under section 3". It is not clear if the initial information collected about the beneficiaries will meet the requirement and, if not, what is reasonable in keeping track of beneficiaries of all trusts administered by the lawyer.

Although we are aware that certain regulated entities monitor media reports and expend significant resources on monitoring the activity of clients and beneficial owners, law firms typically do not engage in these practices. Lawyers and law firms do not have compliance departments whose jobs are solely to ensure compliance with the PCMLTFA. In contrast to banks, lawyers do not have a business need for this information, and in most cases, unlike a regulated entity under the PCMLTFA, client records cannot normally be shared with law enforcement. In such cases, the need for collecting this information needs to be measured against the purpose for which it is collected.

Moreover, it may be premature to import these provisions from the PCMLTFA regime for application to lawyers and law firms. In our understanding, Canadian financial regulators are re-examining their position and interpretation of these provisions in light of feedback from regulated entities, and applying these provisions as proposed before this review has completed could lead to unanticipated results.

Section 6(6)

There are onerous identification provisions for corporate clients in subsection 6(3). However, subsection 6(6) applies in cases where a lawyer is not able to obtain the information referred to in subsection 6(3), and it appears to permit for a much simpler identification regime. The only proviso in using 6(6) is following the requirements of 9 and 10.

However, given that section 9 relates back to 6(3) and section 10 relates back to section 4, using subsection 6(6) for corporate identification does not really impose any greater requirements than set out in section 6(3). As a result we would recommend that greater consideration be given as to when subsection 6(6) could be used appropriately, and what additional or alternative information could be gathered to satisfy the identification requirements.

Section 10 Monitoring

The concept in the PCMLTFA in respect of "ongoing monitoring" and "high risk" clients applies in the context of a transactional relationship. As such, if you have a client that is high risk, you are required to monitor their transactions closely to see if anything seems suspicious or not in keeping with the normal behavior expected of a client with their risk profile (i.e income/ occupation/ownership interests, etc).

This requirement does not translate well to a service relationship where a client is not entering into transactions on a daily, weekly or hourly basis. In that regard, it is difficult to even understand what "ongoing monitoring" is meant to refer to in the context of the lawyer-client relationship. Federally, the term "ongoing monitoring" is defined. It refers to keeping client information up to date, detecting suspicious transactions, assessing a client's risk level and determining if the activities of a client are consistent with information obtained about a client, including their risk assessment.

In the context of the legal profession, however, lawyers and law firms will not typically have this kind of information on clients to "monitor". In fact, because lawyers are not required to file suspicious transaction reports, this requirement is somewhat meaningless.

A more appropriate approach would be to require:

- lawyers to use best efforts to keep information up to date in respect of clients; and,
- use best efforts to ensure a lawyer is not assisting or encouraging a client with fraud, crime, dishonesty or illegal conduct.

In our view, this is the only meaningful application of this section. We believe that it is important that the client intake process (including identity verification) be done correctly by lawyers and law firms. Similarly, it is important for lawyers to keep up to date information on current clients.

However, we note that lawyers do not have any obligations to "manage risk". Our obligation is instead to ensure that we are not assisting clients in illegal activity. In our view, this is another example of a rule designed for other institutions (like banks) being inappropriately applied to lawyers and law firms without appropriate tailoring.

Conclusion

We appreciate the opportunity to comment on these matters, and would welcome the opportunity to provide further feedback as the work of the Committee continues. Please do not hesitate to contact us in this regard.