Federation of Law Societies of Canada

Fédération des ordres professionnels de juristes du Canada

# Submission of the Federation of Law Societies of Canada in response to the Department of Finance paper *Reviewing Canada's Anti-Money Laundering and Anti-Terrorist Financing Regime*

**May 17 2018**

## Introduction

1. The Federation of Law Societies of Canada ("the Federation") appreciates the opportunity to provide a submission in response to the consultation paper *Reviewing Canada's Anti-Money Laundering and Anti-Terrorist Financing Regime* ("Consultation Paper") published by the Department of Finance in February 2018.

2. The Federation is the coordinating body of the 14 regulators of the legal profession in Canada. Our member law societies are statutorily charged by legislation in each province and territory with the responsibility for regulating more than 120,000 lawyers, 3,800 notaries in Quebec and Ontario's nearly 9,000 licensed paralegals in the public interest. An important role of the Federation is to express the views of the regulators of the legal profession on national and international issues relating to the administration of justice and the rule of law.

3. The Federation and its member law societies support Canada's efforts to fight money laundering and terrorist financing. We recognize the importance of the objectives of the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (the "Act") and concur with its basic purpose. It is essential, however, that initiatives to fight these crimes, which include fulfillment of Canada's commitments internationally as a result of its membership in the Financial Action Task Force ("FATF"), respect the framework of the values and constitutional principles on which Canadian society rests. This includes the rule of law, and within that, the right of individuals to an independent judiciary and independent legal counsel.

4. In 2015 the Supreme Court of Canada recognized that the provisions in the Act requiring legal counsel to collect and retain information not required for client representation, expansive powers to search law offices, and inadequate protection for solicitor-client privilege violated provisions of the *Canadian Charter of Rights and Freedoms* and undermined the ability of lawyers and Quebec notaries to comply with their duty of commitment to the client's cause, a principle of fundamental justice.[1]

5. The Consultation Paper repeats the suggestion made on numerous occasions by the Department of Finance that the exclusion of members of the legal profession from the federal anti-money laundering and anti-terrorism financing regime is "a major deficiency". As noted in the Consultation Paper, this same suggestion has been made by the FATF. In its 2016 mutual evaluation report on Canada, the FATF was dismissive of law society regulation to combat money laundering and the financing of terrorist activities. The FATF suggested that as a result of the Federation's successful challenge to the constitutionality of the federal anti-money laundering and terrorist financing scheme, "there is … no incentive for the profession to apply AML/CFT measures and participate in the detection of potential ML/TF activities."[2]

6. In the submission of the Federation these statements ignore both the regulatory authority of Canada's law societies and the significant regulatory initiatives they have

[1] Canada (Attorney General) v. Federation of Law Societies of Canada, [2015] 1 SCR 401, 2015 SCC 7 (CanLII).
[2] Anti-money laundering and counter-terrorist financing measures in Canada – 2016, FATF page 95

taken to mitigate risks of money laundering and terrorist financing in the legal profession. Law societies take their mandate to regulate the legal profession in the public interest seriously and use their extensive investigatory and disciplinary powers to enforce the rules implemented to address money laundering and terrorism financing risks.

7. In our submission, as the authority to regulate the legal profession in Canada rests with the provincial and territorial law societies, the public interest in addressing money laundering and terrorist financing as it relates to the legal profession is best served by having these regulators address any risks that the legal profession may present.

**Federation and law societies anti-money laundering and anti-terrorist financing initiatives**

8. The Federation and the law societies of Canada have been actively involved in the fight against money-laundering and terrorism financing for more than 15 years. Together we have demonstrated our commitment to protecting the public by regulating the legal profession to mitigate the risk of legal counsel engaging in or facilitating these unlawful activities. The development by the Federation of model rules limiting the ability of legal counsel to accept cash (the "No Cash Rule") and imposing extensive client verification obligations (the "Client ID Rule") and their adoption and enforcement by the law societies is evidence of our commitment to proactively regulate in this area. Combined with extensive rules of professional conduct and financial accounting rules, the No Cash Rule and the Client ID Rule provide effective regulation of the risks of members of the legal profession becoming involved in money laundering or the financing of terrorism.

9. The No Cash Rule, adopted in 2004 prohibits legal counsel from receiving cash in amounts over $7,500 and requires them to keep a record of cash transactions as part of their accounting record-keeping. The rule is intended to augment longstanding law society rules aimed at preventing lawyers from being unwittingly involved in unlawful activities, while maintaining the core principles underlying the solicitor-client relationship. The threshold in the Federation's rule is stricter than that in the regulations for reporting large cash transactions ($10,000). By prohibiting legal counsel from accepting cash, the rule addresses the risks associated with the handling and placement of cash and so provides an effective alternative to the reporting requirements that apply to other reporting entities under the federal anti-money laundering scheme. The role played by this rule was recognized by former Finance Minister Jim Flaherty in 2006 while speaking about amendments to the federal anti-money laundering legislation that excluded legal counsel from the suspicious and large cash transaction reporting obligations.

10. To ensure that legal counsel engage in appropriate client due diligence, the Federation adopted a model rule on client identification and verification, the Client ID Rule. The rule, which closely tracks the obligations contained in the federal client identification regulations, has been in force in all Canadian jurisdictions since 2008. Members of the legal profession must identify <u>all</u> clients who retain them to provide legal services by recording basic information such as the client's name, address and telephone number. In addition, when legal counsel provide legal services in respect of the receipt, payment or transfer of funds, they must verify their clients' identity by reference to independent source documents such as a driver's license, birth certificate, passport or other government-issued identification. The Client ID Rule respects the threshold between constitutional and unconstitutional requirements imposed on members of the legal profession when it comes to the gathering of information from clients: legal counsel must obtain and keep all information needed to serve the client, but must not obtain any

information which serves only to provide potential evidence against the client in a future investigation or prosecution by state authorities.

11. Together, the No Cash and Client ID rules accomplish three goals:

    a. the rules impose on lawyers and Quebec notaries a rigorous standard with respect to cash transactions and limit the ability of legal counsel to accept cash from clients;

    b. the rules address the activities of lawyers and Quebec notaries as financial intermediaries but form part of the extensive statutorily authorized regulatory regime for members of the legal profession through law societies rather than federal legislation; and

    c. the rules, as law society regulations, respect the constitutional principles upheld by the legal profession for the benefit of the public, protect the right of citizens to independent legal counsel, and ensure that counsel can continue to protect the client's privilege, which is a constitutionally recognized principle.

12. Legal counsel are also required to abide by comprehensive rules of professional conduct that include provisions prohibiting them from knowingly assisting in or encouraging any unlawful conduct, doing or omitting to do anything that assists in or encourages illegal conduct, or instructing a client or others on how to violate the law. The rules of professional conduct include specific guidance on the need for vigilance due to the risk that transactions for which lawyers and notaries may provide services, such as establishing, purchasing or selling business entities, and purchasing and selling real estate, present for fraud and money laundering. They also identify steps that legal counsel should take when they have any suspicions about the bona fides of any transaction including making reasonable inquiries to obtain information about the subject matter and objectives of the retainer and verifying the identity of the legal or beneficial owners of property and business entities.

13. In addition, extensive trust accounting regulations impose specific requirements on lawyers and Quebec notaries in relation to handling client monies. These regulations address both deposits and withdrawals of client monies and include detailed record-keeping and reporting obligations.

14. Measures to ensure that legal counsel maintain appropriate practice management systems and comply with law society regulations include annual reporting obligations, practice reviews and financial audits. Law societies also have extensive investigatory and disciplinary powers that include the ability to impose penalties up to and including disbarment (revocation of license) when members fail to abide by law society rules and regulations. Lawyers and Quebec notaries are, of course, also bound by the criminal law and those who wittingly participate in criminal activity are subject to criminal charges and sanctions.

15. In the submission of the Federation, any actual or perceived gap in the legislative scheme as a result of the exclusion of members of the legal profession from the provisions of the Act has been filled by these regulatory initiatives.

16. However, the Federation also recognizes that it is important to ensure that regulations aimed at mitigating the risk of legal counsel engaging in illegal activities are as robust and effective as possible. To that end the Federation established a special working group to review the model rules and to consider whether additional regulatory action is required. In the first phase of its work, the group has proposed draft amendments to the rules that clarify some of the provisions and add additional obligations including a requirement for legal counsel to obtain and verify the identity of the beneficiaries of trusts and the beneficial owners of organizations as well as requirements for ongoing monitoring of the professional relationship and the activities of clients. Also proposed is a new model rule (modeled on a rule that several law societies have implemented) that would tie the use of trust accounts to the provision of legal services thus ensuring that lawyer trust accounts cannot be used for purely financial transactions. A consultation on the proposed amendments and new rule ended on March 15, 2018. The working group is now considering the feedback it received and will also be reviewing the various recommendations contained in the Department of Finance Consultation Paper. It is expected that final amendments to the rules will be approved by the Federation and implemented by the law societies later this year.

17. The Federation's working group also has undertaken a review of law society compliance and enforcement activities and is now preparing guidance on best practices to assist law societies in ensuring that their activities in these areas are as effective as possible. The working group will also be preparing comprehensive guidance and educational materials for the legal profession to assist members in understanding the money laundering and terrorism financing risks they may encounter in their professional activities and their associated legal, regulatory and ethical obligations.

**Beneficial ownership**

18. As the Consultation Paper notes, Canada has been criticized by the FATF and others for the lack of transparency on beneficial owners that exists in this country. The Consultation Paper recognizes that access to accurate beneficial ownership information "is vital to combatting illicit financial flows including money laundering, terrorist financing and tax evasion." The Consultation Paper also acknowledges the lack of transparency on beneficial ownership, noting in particular the lack of any central registry.

19. The Federation notes that governments in many countries have recognized the threats posed by a lack of transparency on the beneficial owners of organizations and the beneficiaries of trusts. According to a 2016 report produced by Transparency International Canada[3] the G20, of which Canada is a member, has adopted principles on the transparency of beneficial ownership information and several member states (the UK, France, Australia and South Africa) have committed to setting up public registries of beneficial owners. The European Union has also adopted a requirement for its member countries to collect *and publish* beneficial ownership information. A July 2017 report published by the United States Library of Congress indicates that most countries surveyed have amended their legislation on beneficial ownership in response to either

[3] No Reason to Hide; Unmasking Anonymous Owners of Canadian Companies and Trusts, Transparency International Canada, http://www.transparencycanada.ca/wp-content/uploads/2017/05/TIC-BeneficialOwnershipReport-Interactive.pdf.

the G20 principles or the recommendations of the FATF. The report notes that Canada is one of only 2 G7 countries not to have taken legislative action. [4]

20. We recognize that the government indicated in its recent budget that it plans to introduce legislative amendments to enhance the availability of beneficial ownership information at the federal level. The Consultation Paper describes efforts to "provide clear, standardized direction to corporations as to what information they should record and maintain in terms of their beneficial ownership" as "a critical first step toward improved corporate transparency." But the Consultation Paper stops short of recommending the creation of publicly accessible registries of beneficial owners and appears to suggest there is a need for a public debate on whether beneficial ownership information should be publicly available.

21. In our submission, in light of the identified risk that a lack of transparency creates, it is essential that beneficial ownership information be available in publicly accessible registries. Simply requiring corporations to provide the information to a government agency would be insufficient. As noted above, proposed amendments to the Federation's model rules would add a requirement for legal counsel to obtain and verify information on the beneficial owners of organizations and the beneficiaries of trusts. The proposed amendments reflect the Federation's recognition of the value of capturing this information. It is important to note, however, that the effectiveness of such a rule, which would mirror requirements in federal regulations, will be undermined by the lack of publicly available information on beneficial owners. In the absence of publicly accessible registries of beneficial owners, it simply may not be possible to impose an absolute requirement to verify beneficial ownership information.

22. The Federation recognizes that responsibility for this issue is shared by the federal, provincial and territorial governments, but this jurisdictional complexity ought not to stand in the way of legislative reform. Indeed we note that in its recent budget the government of British Columbia announced plans to track beneficial ownership information of property, organizations and trusts. The Federation supports these plans and urges the federal government to move forward promptly with legislative initiatives that include the creation of a publicly accessible registry of beneficial owners and to continue to work with the provincial and territorial governments toward similar amendments to the legislation in their respective jurisdictions.

## Conclusion

23. For most of the past decade the dialogue about efforts to address the risks of involvement by legal counsel in money laundering and terrorism financing activities has been focused on the government's attempts to include legal counsel in the scope of the federal regulatory regime. Since the 2015 decision of the Supreme Court, the focus has been on concerns about the continued exclusion of the legal profession from the federal framework and suggestions that renewed efforts would be made to bring lawyers and Quebec notaries within the reach of the federal regulations. This focus is reflected in the Consultation Paper in which the Department of Finance states that it "continues to

[4] Disclosure of Beneficial Ownership in Selected Countries, July 2017, Library of Congress, https://www.loc.gov/law/help/beneficial-ownership/disclosure-beneficial-ownership.pdf.

believe that the application of the rules to the legal profession is important to maintain the integrity of Canada's AML/ATF framework" and reiterates its "intention to develop constitutionally compliant legislative and regulatory provisions that would subject legal counsel and legal firms to the [Act]."

24. In the submission of the Federation, this dialogue fails to acknowledge the very meaningful role that the regulators of the legal profession are playing in the fight against money laundering and terrorism financing as they fulfill their regulatory mandates. In our view it is time to change the nature of the dialogue and to find a way to work together that recognizes the shared goals of the regulators and the government while respecting the constitutional framework within which we operate. We look forward to engaging with the government on this important issue.