Response to the Proposed Amendments to the Model Rules of Professional Conduct of the Federation of Law Societies of Canada re: Anti-Money Laundering

Submitted to:

The Law Society of Ontario
130 Queen Street West
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The Law Society of Ontario's Professional Regulation Committee has requested input from the profession on a number of proposed amendments to the Model Rules of the Federation of Law Societies of Canada (FLSC).

Thank you for the opportunity to provide written submissions on this very important issue impacting the practising bar across Ontario.

The Federation of Ontario Law Associations (FOLA) is an organization that represents the associations and members of the 46 local law associations found across Ontario. Together with our associate member, the Toronto Lawyers' Association, we represent approximately 12,000 lawyers, most in private practice in firms across the province as they provide service to the public and operate their businesses. These lawyers are on the front-lines of the justice system and see its triumphs and shortcomings every day. Rules on cash transactions are of great interest to many lawyers and we hope these comments provide useful input to the Federation of Law Societies of Canada.

A. MODEL RULE ON CASH TRANSACTIONS

Adopted by Council of the Federation of Law Societies of Canada as of July 2004

1. Amount of cash that can be accepted by lawyers

The (FLSC) Working Group is proposing an amendment to paragraph 1 of this Model Rule to clarify that lawyers may not accept cash in an amount greater than $7,500. The FLSC Working Group is of the view that the threshold is appropriate, but there is confusion as to whether or not an amount of $7,500 can be accepted (or whether it is $7,501 and over). The proposed amended would clarify that accepting cash in an aggregate amount of greater than $7,500 would be prohibited.

FOLA Comments:

We have no concerns with the proposed amendment and appreciate the clarification as to the amount of cash that can be accepted.

2. Exceptions to "no cash" rule

The FLSC Working Group is proposing changes to paragraph 4 so that:

i) the "no cash" rule would apply only when the lawyer or law firm is providing legal services; and

ii) the exceptions for receipt of cash from peace officers, law enforcement agencies or other agents of the Crown acting in their official capacity, and the receipt of cash pursuant to a court order, or to pay a fine or penalty are eliminated.

The Committee is interested in receiving comments regarding whether the removal of these exemptions would have an adverse impact on criminal lawyers.

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FOLA Comments:

We have no concerns with the amendments confirming that the "no cash" rule would only apply when the lawyer or the law firm is providing legal services.

The exceptions in (b) and (c) should remain. While they may seem rarely used, they are an effective tool in assisting the administration of criminal justice. Just because a tool may be rarely used does not eliminate its utility. Many individuals involved in the criminal justice are unsophisticated. The problems which affect many of them, such as addiction or mental health issues, mean that they often do not have access to even simple banking methods. That being said, for some, access to cash is more likely. The ability to utilize this option to put a lawyer in funds to make payment on behalf of a client allows a greater ability to resolve matters without the need for a trial. Resolution contingent upon outstanding fines or restitution being paid or lawyers being able to undertake to pay expected fines on behalf of a client are tools which aid in resolution of criminal matters on a daily basis.

Further to this, the ability to accept payment from police or enforcement agencies in cash is important as it allows lawyers to access funds which may have been seized as part of a criminal investigation. This gives a wider ability to lawyers to take on cases and increases access to justice in cases where cash has been seized. As police agencies are loath to process cash and issue a cheque or money order in relation to funds seized, cash is the only method for the utilization of these funds.

B. MODEL RULE ON CLIENT IDENTIFICATION AND VERIFICATION REQUIREMENTS

Adopted by Council of the Federation of Law Societies of Canada March 20, 2008 and modified on December 12, 2008

As explained on the Law Society's website, there is a distinction between client identification and client verification. Lawyers and paralegals are required to identify a client, or obtain certain basic information about them, whenever they are retained to provide legal services.

In contrast, verifying the identity of client involves actually looking at the original identifying document from an independent source to ensure that the client or any third party who is who they say they are.

1. Compliance with Model Rules

The FLSC Working Group is proposing to amend section 2(1) of this Model Rule as a reminder to legal professionals that the client identity and verification rules are part of the general obligation to know a client and understand the nature of the retainer.

Current rule:

2.(1) Subject to subsection (3), a lawyer who is retained by a client to provide legal services must comply with the requirements of this Rule.

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Proposed amendment:

2.(1) Subject to subsection (3), a lawyer who is retained by a client to provide legal services must comply with the requirements of this Rule in keeping with the lawyer's obligations to know their client, understand their client's financial dealings in relation to the retainer with the client and manage any risks arising from the professional business relationship with the client.

FOLA Comments:

This amendment seems to be in keeping with Law Society's Rule 3.2-7, which obligates lawyers to make reasonable efforts to ascertain the purpose and objectives of a retainer and refrain from doing or omitting to do anything that the lawyer knows or ought to know will be assisting in, encouraging or facilitating any dishonesty, fraud, crime, or illegal conduct by a client or any other person and accordingly we have no concerns with this proposed amendment.

2. Identification vs. verification

The Committee seeks feedback about whether the marginal note above Model Rule 4 ("Client Identity and Verification") should be amended to refer to verification only, in order to ensure clarity with respect to the distinction between client identification and verification. The Committee notes that the subject matter of the Rule relates to verification rather than to identification.

FOLA Comments:

We are uncertain as the current wording of the marginal note above Model Rule 4, but generally note that the distinction between obtaining client identification and verifying the identity of the client is worth highlighting.

3. Removal of reasonableness in identifying and verifying clients

One of the amendments made to the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* Regulations is the removal of the "reasonable measures" standard regarding client identification and verification, which is no longer used. The FLSC Working Group notes that this is a significant change and recommends the removal of the works "take reasonable steps" from the Model Rule to ensure consistency with the Regulations.

Current rule:

6. (1) When a lawyer is engaged in or gives instructions in respect to any of the activities described in section 4, including non-face-to-face transactions, the lawyer shall take reasonable steps to verify the identity of the client, including the individual(s) described in section 3, clause (f)(ii), and, where appropriate, the third party, using what the lawyer reasonably considers to be reliable, independent source documents, data or information.

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Proposed amendment:

6. (1) When a lawyer is engaged in or gives instructions in respect to any of the activities described in section 4, ~~including non-face-to-face transactions,~~ the lawyer shall ~~take reasonable steps to~~

(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 section 3, clause ~~(f)(ii)~~ b(v), and, where appropriate, the third party, using ~~what the lawyer reasonably considers to be~~ documents or information from a reliable, independent source ~~documents, data or information~~.

FOLA Comments:

The "reasonable" requirement should remain unless it is absolutely necessary to remove it in order to ensure consistency with the federal regulations. Without defining what constitutes a "reliable, independent source", lawyers and paralegals must be able to use a reasonable standard to determine same.

What happens in a situation where a client is not able to provide identification in the usual course? For example, we have reports from lawyers with elderly clients who no longer have valid driver's licences or passports. If they live with family or in a retirement/nursing home, they may not have utility bills in their name with their address or other forms of acceptable verification documents. If the lawyer has known the client personally for a reasonable period of time, is that sufficient for verification of identity purposes?

Further, there needs to be some clarification regarding the meaning of "source of funds". If a client has provided a certified cheque or bank draft from a financial institution for the closing of a real estate transaction or settlement of a litigation matter, is the lawyer required to determine how the client obtained the funds in the account upon which the cheque/draft is drawn or simply required to confirm that the cheque/draft is from a financial institution (as defined in the Model Rule)?

4. Risk factors in client verification

The Committee notes that currently, there is no reference to risk factors of which lawyers and paralegals should be aware when verifying a client's identity. If the source of funds is an organization that is subject to the PCMLTFA, additional inquiries may not be necessary. However, if the origin of the source of funds is uncertain, the lawyer or paralegal should be aware that there is a possibility of money laundering or terrorist financing and should make additional inquiries of the client. The Committee is seeking feedback about whether additional Commentary should be added to clarify these issues.

FOLA Comments:

It would be useful to include guidance for lawyers and paralegals as to the risk factors to be aware of when verifying a client's identity and what additional inquiries should be made of the client, as we do not believe this information is readily known.

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5. Identifying individuals under the age of 12

The FLSC Working Group is recommending changes to paragraph 6(2) of the Client Identification Rule to specify the documents and information that may be relied upon to verify the identity of an individual under the age of 12 to reflect amendments to the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* Regulations.

Proposed amendment:

Examples of independent source documents

6(2)For the purposes of subsection (1), independent source documents may include:

(a) if the client or third party is an individual, valid original government issued identification, including a driver's licence, birth certificate, provincial or territorial health insurance card [if such use of the card is not prohibited by the applicable provincial or territorial law], passport or similar record;

(b) if the client or third party is an organization such as a corporation or society that it created or registered pursuant to legislative authority, a written confirmation from a government registry as to the existence, name and address of the organization, including the names of its directors, where applicable, such as

(i) a certificate of corporate status issued by a public body,

(ii) a copy obtained from a public body of a record that the organization is required to file annually under applicable legislation, or

(iii) a copy of a similar record obtained from a public body that confirms the organization's existence;

(c) <u>in verifying the identity of an individual who is under 12 years of age, the lawyer shall verify the identity of one of their parents or their guardian;</u> and

(d) if the client or third party is an organization, other than a corporation or society, that is not registered in any government agency, such as a trust or partnership, a copy of the organization's constating documents, such as a trust or partnership agreement, articles of association, or any other similar record that confirms its existence as an organization.

FOLA Comments:

The wording of proposed 6(2)(c) requires clarification to confirm whether there is a requirement to verify the identity of the parent instead of, or in addition to, identifying the child.

6. Removal of reasonableness in identifying Directors, Shareholders and Owners

The FLSC Working Group proposes the amendment of Model Rule 6(3) to reflect the change in the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* that removed

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"reasonable measures" from the obligations of financial institutions to obtain ownership information from customers and beneficiaries that are legal entities.

Current rule:

6(3) When a lawyer is engaged in or gives instructions in respect of any of the activities in section 4 for a client or third party that is an organization referred to in subsection (2)(b) or (c), the lawyer shall make reasonable efforts to obtain, and if obtained, record,

(a) the name and occupation of all directors of the organization, other than an organization that is a securities dealer, and
(b) the name, address and occupation of all persons who own 25 per cent or more of the organization or of the shares of the organization.

Proposed rule:

6(3) When a lawyer is engaged in or gives instructions in respect of any of the activities in section 4 for a client or third party that is an organization referred to in ~~subsection~~ (2)~~(b)~~ (e) or ~~(c)~~ (f), the lawyer shall ~~make reasonable efforts to~~ obtain, and if obtained, record,

(a) the name and occupation of all directors of the organization, other than an organization that is a securities dealer, ~~and~~
(b) the name<u>s</u>, address<u>es</u> ~~and occupation~~ of all persons who <u>directly or indirectly</u> own 25 per cent or more of the organization or of the shares of the organization, and

(c) <u>the names and addresses of all trustees and all known beneficiaries and settlors of the trust, and</u>

(d) <u>in all cases, information establishing the ownership, control and structure of the entity.</u>

6(4) A lawyer shall take reasonable measures to confirm the accuracy of the information obtained under subsection (3).

6(6) <u>if a lawyer is not able to obtain the information referred to in subsection (3) or to confirm that information in accordance with subsection (4), the lawyer shall</u>

(a) <u>take reasonable measures to ascertain the identity of the most senior managing officer of the entity; and</u>
(b) <u>treat the activities in respect of that entity as requiring ongoing monitoring and if necessary take the steps such monitoring may require, as described in section 9 and 10 of this rule.</u>

The Committee seeks input from the profession regarding the following:

i) Should the obligation to make reasonable efforts to identify directors, shareholders and owners remain, unless it is absolutely necessary to remove it in order to create a more robust requirement that would be consistent with federal regulations?

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FOLA Comments:

Yes, the reasonableness standard should be retained. If section 6(3) is modified to remove "reasonable efforts", the directive becomes a mandatory obligation, and the proposed 6(6) become irrelevant. If a lawyer "shall obtain", there is no option to not obtain the information and proceed as contemplated in section 6(6).

ii) Would the requirement to obtain the names of the organization or of the shares of the organization impose a significant responsibility on the lawyer to ask about and document corporate and other ownership structures that could be very complex?

FOLA Comments:

Yes, ownership structures can be intensely complex. Intricate corporate ownership structures involving trusts, limited partnerships, and joint ventures are common in large commercial real estate transactions, and this requirement could be onerous for commercial real estate lawyers and corporate/commercial lawyers whose retainers would frequently involve the transfer of funds on behalf of their clients. Without public corporate registries for lawyers to rely on, these obligations can become onerous and by deleting the "reasonable measures" provisions from the Model Rule, may be impossible to achieve.

iii) Is there sufficient clarity as to whether the 25 percent requirement refers to votes, equity ownership, or both? With respect to equity, does this mean entitlement to income or capital? Is clarification needed in order to ensure compliance with this requirement?

FOLA Comments:

Clarification of these issues is required.

iv) Proposed paragraph "d" would require a lawyer to obtain and record "in all cases, information establishing the ownership, control and structure of the entity". Is there sufficient clarity about whether the word "control" means *de facto* control as well as *de jure* control? If *de facto* control is what is intended, the lawyer will be required to make inquiries about shareholders or other agreements or circumstances which might provide a person or group with direct or indirect influence which could result in control in fact of the entity. The Committee seeks feedback about whether this requirement would impose an onerous due diligence obligation.

FOLA Comments:

Clarification regarding the meaning of "control" is required. If it is intended that control means de facto control, the lawyer has no public registry upon which to rely and guidance as to how to determine such information is needed.

There is no public registry that includes information on beneficial ownership. Corporate registries in Ontario do not contain shareholder or beneficial ownership information. In addition, the land registration system prohibits the registration of title "in trust" except for

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specific trustees such as Estate Trustees and Trustees in Bankruptcy, so beneficial ownership of title is not even publicly recorded.

Consequently, compliance with this rule may sometimes be difficult and there is no way for a lawyer to independently confirm the information provided by the client.

v) The Committee also seeks comments about whether a lawyer should be entitled to rely on the certificate of a senior officer of the entity to satisfy the requirements in section 6(3)(b) and 6(4).

FOLA Comments:

A lawyer should be entitled to rely on the certificate of a senior office of the entity to satisfy these requirements, provided the lawyer does not know or ought to know information to the contrary. In many instances there may be no way for a lawyer to independently verify this information. In addition, allowing lawyer to rely on such a certificate is consistent with indoor management rule (s.19) of the Business Corporations Act (Ontario).

7. Client identification and verification in non face-to-face transactions

Clients within Canada

The FLSC Working Group is recommending that the Client Identification Rule be amended to remain consistent with the federal scheme. It is proposed that Rule 6(4) (5) and (6) be deleted. These sections allow a lawyer to verify the identity of a client who is not physically present before the lawyer but is present elsewhere in Canada by way of an attestation from a commissioner or guarantor who has seen an original identification document.

FOLA Comments:

The deletion of these sections with no alternative replacement will require lawyers who are acting for clients in matters that involve the receiving, paying or transferring of funds to personally verify the identity of clients who are in Canada, regardless of whether or not the client is physically present before the lawyer. This is impractical when the client is not able to be physically present before the lawyer but is in Canada and should be revisited.

The FLSC Working Group is proposing to add the following rule:

Proposed rule:

6(5) *A lawyer shall keep a record, with the applicable date(s), that sets out the information obtained and the measures taken to confirm the accuracy of the information.*

This proposed rule provides two obligations on the lawyer- first, to obtain and record the information from the client and second, to take measures to confirm the accuracy of the information. The Committee suggests that the provision be amended to provide that the lawyer should obtain the information from sources that the lawyer reasonably believes to be reliable and keep a record of the sources consulted.

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FOLA Comments:

We agree with the suggestion to add a reasonableness standard to this proposed rule.

Clients outside of Canada

Model Rule 6(7) permits a lawyer to use an agent to obtain necessary information to verify the identity of a client if an individual client, third party or individual is not physically present in an is outside of Canada. The Working Group is proposing that the reference to an attestation in Model Rule 6(7) would be removed.

Current rule:

6(7) A lawyer may, and where an individual client, third party or individual described in s.3 clause (f)(ii) is not physically present and is outside of Canada, shall, rely on an agent to obtain the information described in subsection (2) to verify the person's identity, which may include, where applicable, an attestation described in this section, provided the lawyer and the agent have an agreement or arrangement in writing for this purpose.

Proposed amendment:

6(7) A lawyer may, and where an individual client, third party or individual described in s.3 clause ~~(f)(ii)~~ (b)(v) is not physically present and is outside of Canada, shall, rely on an agent to obtain the information described in subsection (2) to verify the person's identity~~, which may include, where applicable, an attestation described in this section~~, provided the lawyer and the agent have an agreement or arrangement in writing for this purpose.

6(8) A lawyer who enters into an agreement or arrangement referred to in subsection (7) shall

(a) obtain from the agent the information obtained by the agent under that agreement or arrangement; and
(b) satisfy themselves that the information is valid and current and that the agent verified identity in accordance with subsection (2).

6(9) A lawyer may rely on the agent's previous verification of an individual client, third party or an individual described in section 3 clause (b)(v) if the agent was, at the tiem they verified the identity,

(a) acting in their own capacity, whether or not they were required to verify identity under this Rule, or
(b) acting as an agent under an agreement or arrangement in writing, entered into with another lawyer who is required to verify identity under this Rule, for the purpose of verifying identity under subsection (2).

Proposed Rule 6(9) would allow a lawyer to rely on the agent's previous verification of an individual, but does not require a lawyer to satisfy themselves that the information is valid

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and that the agent verified identity. If it is assumed that the two sections are read together, it may not be necessary to insert this language. If not, the Committee is considering whether such language should be incorporated into the Rule.

FOLA Comments:

It is not necessary include further language in this regard into proposed Rule 6(9), as it is sufficiently clear in Rules 6(7) that a lawyer must have a written agreement or arrangement with an agent to rely on an agent to obtain the information. Further, Rue 6(8) is clear that as to the obligations of the lawyer who enters into an agreement or arrangement with an agent pursuant to Rule 6(7).

8. Timing of verification for organizations

The FLSC Working Group is proposing to modify Rule 6(12) to reduce the time to verify the identity of an organization from 60 to 30 days. According to the FLSC consultation paper, Law Societies expressed concerns to the FLSC Working Group that a transaction could be completed before the 60 day time period, thus undermining the purpose of the requirement.

Current rule:

6(11) A lawyer shall verify the identity of a client that is an organization within 60 days of engaging in or giving instructions in respect of any of the activities described in section 4.

Proposed rule:

6(12) A lawyer shall verify the identity of a client that is an organization ~~within 60 days of~~ upon engaging in or giving instructions in respect of any of the activities described in section 4, but in any event no later than 30 days thereafter.

The Committee is seeking feedback about whether the time period to verify the identity of an organizational client should be reduced. The Committee also requests comments about whether the Model Rule should be amended to require the lawyer to verify the organizational client's identity within 30 days of being engaged or receiving instructions in respect of the activities described in section 4, or the transaction completion date, whichever is sooner.

FOLA Comments:

The triggering event for this section is engaging in or giving instructions in respect of the receiving, paying or transferring of funds, other than an electronic funds transfer. A lawyer should reasonably be able to verify the identity of an organizational client within 30 days of this, so a reduction from 60 to 30 days is acceptable.

While it does seem to make sense to further amend this requirement to be the earlier of 30 days following the triggering event or the transaction completion date, the meaning of "transaction completion date" must be clarified. Does this mean the completion of the matter

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for which the lawyer was retained or the specific monetary activity described in section 4? In a real estate context, for example, if a lawyer receives a deposit on account an agreement of purchase and sale, is the receipt of the deposit the triggering event or is it the completion of the agreement of purchase and sale?

9. Monitoring

The FLSC Working Group is recommending the addition of a new provision in the Client Identification and Verification Requirements regarding ongoing monitoring of clients. This requirement would reflect the changes to the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* Regulations. As a result of these amendments, entities that are subject to the legislation are required to perform ongoing monitoring of business relationships to mitigate the risk of facilitating money laundering or terrorist financing.

Proposed rule:

10. During a retainer with a client in which the lawyer is engaged in or gives instructions in respect of any of the activities described in section 4, the lawyer shall

(a) monitor on a periodic basis the professional business relationship with the client for the purposes of:

(i) determining whether

(A) the client's information in respect of their activities,

(B) the client's information in respect of the source of the funds described in section 4, and

(C) the client's instructions in respect of transactions

are consistent with the purpose of the retainer and the information obtained about the client as required by this Rule, and

(ii) ensuring that the lawyer is not assisting in or encouraging dishonesty, fraud, crime or illegal conduct, and

(b) keep a record, with the applicable date of the measures taken and the information obtained with respect to the requirements of (a) above.

FOLA Comments:

Clarification as to whether the obligation to monitor applies only to high risk clients (such as clients from a jurisdiction where the production of drugs, drug trafficking, terrorism or corruption is prevalent), or to all situations in which a lawyer is engaged or gives instructions with respect to the activities listed in section 4 is required. When read in conjunction with the proposed 6(6) this is not clear, as 6(6) indicates that when the lawyer is not able to obtain or confirm the information referred to in subsections (3) or (4), then the lawyer should "treat the activities in respect of that entity as requiring ongoing monitoring and if necessary take the steps such monitoring may require, as described in sections 9 and 10 of this Rule".

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Large institutional clients will have ongoing relationships with law firms involving a variety of matters and different lawyers who are working on these matters. The Rule, as drafted, is not sufficiently clear as to whether the requirement to monitor extends throughout the entire lawyer-client relationship, or only for the duration of the matter for which the verification was completed.

It may be difficult to comply with proposed subsection 10(b), as the act of watching for red flags may be an ongoing process rather than a measure that can be periodically recorded, and this section should be revised or deleted.

C. MODEL RULE ON TRUST ACCOUNTS

(Proposed)

1. Trust Accounting

The use of a trust account for purposes that are unrelated to the provision of legal services is prohibited in Ontario, Quebec and Alberta, since such activities can be used to launder funds or to facilitate other illegal activities. The Model Rules do not currently address this issue and the FLSC Working Group is proposing a new rule which does.

Proposed rule:

Model Trust Accounting Rule

1. *All deposits or transfers into, and withdrawals from a trust account must be directly related to an underlying transaction or transaction or matter for which the lawyer or the lawyer's law firm is providing legal services.*

2. *Money held in a trust account must be paid out as soon as practical upon the completion of the transaction or other matter.*

Commentary:

[1] Even when the use of the trust account is related to the provision of legal services, the lawyer should consider whether it is appropriate in all the circumstances. Where, for example, a lawyer provides legal services in connection with a transaction that does not involve any escrow or trust conditions, the deposit or transfer of money into and withdrawal or transfer from the trust account may be mere banking services and so prohibited.

FOLA Comments:

The Commentary should be reviewed and the second sentence should be deleted. It could be interpreted to refer to situations in which a lawyer receives funds from a client in order to complete a purchase transaction where the funds are merely received and then immediately paid to the lawyer acting for the other party, or to situations where a lawyer receives client funds in order to pay disbursements. Further, would a client retainer, held in trust on a litigation matter be a "transaction that does not involve escrow or trust conditions"?

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