

Money Laundering Regulation—What Can be Learned from the Canadian Experience

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Within the Canadian federal democracy, provincial legislators are constitutionally responsible for legislation governing the legal profession. The Federation of Law Societies of Canada (the “Federation”) is the coordinating body of the 14 governing bodies that are statutorily charged with the responsibility of governing Canada’s 95,500 lawyers and 3,500 notaries in Quebec in the public interest. As such, the Federation undertakes various national initiatives, including those that facilitate mobility of the legal profession within Canada, as well as the development of national standards for the regulation of the profession, including codes of conduct and other rules. It is a leading voice on a wide range of issues of national and international importance involving justice and regulatory matters critical to the protection of the public.

The Federation, on behalf of its member law societies, has publicly stated its support for the Canadian government’s efforts to fight money laundering and terrorist financing, recognizing the importance of the objectives of federal legislation and concurring with its basic purpose. However, the Federation has also expressed the belief that initiatives to fight these crimes, which include fulfillment of Canada’s commitments internationally through its membership in the Financial Action Task Force (“FATF”), must be accomplished within the framework of Canadian societal values and constitutional principles. Indeed, the FATF recommendations recognize the need to accommodate such principles in individual jurisdictions. For example, Recommendation 16 states that lawyers are not required to report suspicious transactions if the information was obtained in circumstances where they are subject to professional secrecy or professional privilege.

Suspicious Transaction Reporting

In 2000, following the FATF’s adoption of its 40 Recommendations, the Canadian Parliament passed legislation now known as the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (the “Act”). Under the Act, regulated

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persons and entities are required to report suspicious transactions and certain other financial transactions (later prescribed in regulations as those involving \$10,000 or more in cash). These reports must be made to the Financial Transactions and Reports Analysis Centre of Canada (“FINTRAC”), a federal agency that was set up to receive and analyze financial intelligence and disclose it to police. Reporting persons are prohibited from “tipping off” their client about having made the report.¹

Despite concerns expressed by the Federation, in November 2001 the Federal government promulgated regulations making the Act applicable to lawyers, and requiring legal counsel to secretly report suspicious transactions by their clients to FINTRAC. The Federation and the Law Society of British Columbia, supported by the Canadian Bar Association, initiated proceedings in the Supreme Court of the province of British Columbia challenging the constitutionality of the legislation and seeking interlocutory relief from the application of the Regulations to legal counsel.

The essence of the constitutional challenge² was that the legislation, including obligations to report suspicious and prescribed transactions, required lawyers to act as secret agents of the state, collecting information about clients against their interests and secretly reporting to a government agency. The contention was that the legislation threatened fundamental Canadian constitutional principles, which require that lawyers maintain undivided loyalty to their clients, consistent with the independence of the bar and the integrity of the administration of justice. The Supreme Court of Canada has affirmed that lawyers, who are bound by stringent ethical rules, must not have their offices turned into archives for the use of state authorities.³

The B.C. Supreme Court accepted these arguments, finding that the legislation represented “an unprecedented intrusion into the traditional solicitor-client relationship”.⁴ The court granted an interim injunction exempting legal counsel from the requirement to report “suspicious transactions” pending a full hearing on the merits of the case. The B.C. Court of Appeal affirmed the order,⁵ and the Supreme Court of Canada, Canada’s highest court, denied the government’s ap-

1. Section 8 of the Act, which relates to the suspicious transaction report required by section 7, provides: “No person or entity shall disclose that they have made a report under section 7, or disclose the contents of such a report, with the intent to prejudice a criminal investigation, whether or not a criminal investigation has begun.”

2. See the decision of the Honourable Madam Justice Allan of the British Columbia Supreme Court in *Law Society of British Columbia v. Canada (Attorney General)*, (2001) 207 D.L.R. (4th) 705, available at <http://www.canlii.com/bc/cas/bcsc/2001/2001bcsc1593.html>.

3. *Maranda v. Richer*, 2003 SCC 67, available at <http://www.canlii.org/en/ca/scc/doc/2003/2003scc67/2003scc67.html>.

4. Law Society, *supra* note 2 at para. 108.

5. 2002 BCCA 49 (CanLII), available at <http://www.canlii.org/en/bc/bcca/doc/2002/2002bcca49/2002bcca49.html>.

plication for a stay.⁶ Similar orders were granted in other provinces and territories across Canada. As a result of these interlocutory orders, in May 2002 the Attorney General of Canada agreed to suspend the application of the legislation to all Canadian lawyers (including Québec notaries), pending a final decision on the merits of the constitutional challenge to the legislation. At the time the federal government indicated that following consultations with the legal profession, the government intended to put in place a new regulatory regime for lawyers that more appropriately reflected their duties. In the meantime, the parties agreed to adjourn the constitutional challenge indefinitely and all lawyers in Canada remain exempt from the legislation, and any new regulations, by virtue of the injunction.⁷

The government has since amended the Act to exempt lawyers from the suspicious transaction reporting requirements. While perhaps not an acknowledgment by the Federal government that the rules violated fundamental constitutional principles relating to the solicitor-client relationship, it was an acknowledgment of the Federation's actions taken to combat money-laundering through the development of a model "No-Cash Rule". This rule, which prohibits lawyers from receiving cash of \$7,500 or more except in very limited circumstances, has been adopted by all Canadian law societies.

The "No Cash Rule" demonstrated the Canadian legal community's support for the fight against money-laundering, but did so in the context of a self-regulating and independent bar. This rule essentially rendered unnecessary the obligation to report large cash transactions (\$10,000 or more) as none could occur in a lawyer's office. Indeed, the Federation's rule was stricter than the FATF requirements.

The injunction and subsequent amendment of the legislation, coupled with the government's acknowledgement that law societies are serious about exercising their mandate to regulate in this critical area, was an important victory.

Identification and Verification Regulation and the Federation's Know Your Client Model Rule

To date we have not met with the same success in the area of Know Your Client regulations. In late 2007 the federal government adopted regulations making the identification verification portions of the Act applicable to members of the legal profession. These regulations came into effect at the end of 2008, but because of the current injunction they do not apply to lawyers or Quebec notaries.

Prior to introduction of the latest regulations, concerns were expressed about the exemption of lawyers from the obligations under the Act by the Department of Finance and the Auditor General of Canada in their reviews of the Canadian anti-money laundering and terrorist financing regime.

6. [2002] S.C.C.A. No. 52.

7. The injunction provides that any new Regulations will not apply to the legal profession unless the Federation and the other parties to the litigation consent.

In a November 2004 report, for example, the Auditor General indicated that “[t]he removal of lawyers from the reporting requirements of the legislation in Canada means that our anti-money laundering system does not fully meet international [FATF] standards, yet meeting them was one of the objectives of the National Initiative to Combat Money Laundering.”⁸

It would appear sentiments such as this are at least partially responsible for the government’s insistence on enacting regulations relating to the legal profession.

The federal government has also insisted that implementation of the FATF recommendations in this area must be by legislation or government regulation, and cannot be accomplished by relying on self regulating organizations (“SROs”) to regulate their members. This is a matter of debate.

In an effort to persuade the government that direct regulation by law societies is not only necessary constitutionally, but is also more efficient and effective, representatives of the Federation held several meetings with the federal government prior to enactment of the identification and verification regulations. In those meetings we explained law societies’ regulatory oversight of the profession (grounded in provincial legislation), the comprehensiveness of their regulation and enforcement, and the intention of the law societies to regulate in the area of client identification.

Indeed, the Federation developed another model rule, this one dealing with client identification, which has now been adopted by all law societies. As was the case with the “No Cash Rule” the Model Rule on Client Identification and Verification (“Model Rule”) is in some ways stricter than the requirements of the federal regulations.

Nevertheless the federal government enacted the regulations purporting to subject members of the legal profession to the verification requirements established pursuant to the Act. While the injunction granted in the litigation over the suspicious transaction reporting regulations prevents application of the regulations without the consent of the Federation and the other parties to that litigation the issue remains unresolved. Trial dates have now been set for 2011 in the outstanding litigation where the issues related to these regulations will be addressed.

In the meantime, the law societies in Canada are doing what they should: regulating lawyers in the area of client identification.

Creation of the Model Rule by the Federation’s Anti-Money Laundering Committee began as an independent initiative to address lawyers’ “know your client” obligations. The Model Rule sets out the client identification information a lawyer is required to obtain when retained by a client. In many respects, the Model Rule codifies the steps a prudent lawyer would take in the normal course to verify a client’s identity upon being retained to provide legal services. Simply put, to

8. 2004 November Report of the Auditor General of Canada at 2.32, *available at* http://www.oag-bvg.gc.ca/internet/English/parl_oag_200411_02_e_14906.html.

eliminate the risk of unknowingly assisting in some form of illegal activity, all lawyers should ensure the person they deal with as a client is actually who they say they are.

The Model Rule is consistent with the ethical obligations of members of the legal profession and duty to their clients to obtain and keep information relevant to providing the legal services in question. It is not designed or intended for the member of the profession to obtain information that would serve only to provide potential evidence against the client in a future investigation or prosecution by State authorities.

The following outlines the key features of the Model Rule

1. Application

The Model Rule applies whenever a lawyer provides legal services to a client. The client identification requirements call for basic identification information about individual or organizational clients in every retainer. The identity verification requirements are triggered where the lawyer receives, pays or transfers funds on behalf of a client or gives instructions for such activities on behalf of a client.

Lawyers are exempt from the requirements: where the lawyer provides the legal services on behalf of his or her employer; where a lawyer is engaged as an agent by a lawyer for a client or is referred a matter from a lawyer who has complied with the rule; and when providing certain legal services through provincial and territorial legal aid plans.

The verification provisions of the Model Rule do not apply when the client is a financial institution, public body or reporting issuer (all defined in the Model Rule) or when the funds involved are

- paid by or to a financial institution, public body, or a public company or entity,
- received by a lawyer from the trust account of another lawyer,
- received from a peace officer, law enforcement agency or other public official acting in their official capacity,
- paid pursuant to a court order or to pay a fine or penalty,
- paid as a settlement of a proceeding, or
- received for professional fees, disbursements, expenses or bail
- sent or received by electronic funds transfer.

2. Client Identification Requirements

The identification provisions, applying to all retainers for legal services, require lawyers to obtain and record:

- the client's full name,
- the client's home or business address,
- the client's home or business telephone number,
- where the client is an individual, the client's occupation,

- where the client is an organization (other than a financial institution, public body or public company/entity), the general nature of the type of business engaged in by the organization, where applicable,
- where the client is an organization, the individuals authorized to give instructions with respect to that organization, and
- where the client is acting for a third party beneficiary, necessary information about the beneficiary, such as that set out above.

3. *Client Identity Verification Requirements*

The requirements in the Model Rule oblige lawyers to make reasonable efforts to verify the identity of clients through independent source documents and to maintain a record of the documents used for this purpose. For individuals, independent source documents include government-issued identification, such as a driver's license, birth certificate, provincial health card or passport or a similar record. For organizations, appropriate documents include the incorporating documents of the organization, confirmation from a government registry as to the existence and name of the organization, including the name of its directors and officers, or a copy of the organization's constating document(s).

Lawyers are also required to make reasonable efforts to obtain and if obtained, record, the name and occupation of all directors, and the name, address and occupation of all persons who own 25% or more of the organization.

For client identification and verification in non-face-to-face situations, when the client is situated elsewhere in Canada, the lawyer may obtain an attestation from a commissioner of oaths or guarantor in Canada that he or she has seen one of the documents that will verify the client's identity. A list of individuals who qualify to provide the attestation is included in the Model Rule. The lawyer may also use an agent with whom the lawyer has an agreement in writing for the purposes of identifying the client. If an individual client is not present in Canada, the lawyer *must* use an agent for the purposes of obtaining and verifying the client's identity.

The Model Rule requires that the identity of individual clients be verified at the time the lawyer engages in or gives instructions in respect of the receiving, paying or transferring of funds in relation to these clients. For organizational clients, the verification must occur within 60 days of these activities.

The Model Rule provides that "re-identification" is not required for clients on new matters, qualified by the need for the lawyer to recognize the individual client.

4. *Record Keeping Requirements*

The Model Rule requires lawyers to obtain and keep a copy of the information recorded for client identity and the documents obtained to verify the client's identity. The documents, which may be kept in machine-readable or electronic form, are to be kept for the duration of the relationship with the client and for as long as is necessary to fulfill the requirements of the retainer, but in no event less than six years.

5. *Duty to Withdraw*

The Model Rule also requires a lawyer to withdraw from providing legal services when he or she knows or ought to know that the provision of the services would assist a client in criminal or illegal activity. These duties are similar to those in place in law societies' rules or codes of professional conduct.

6. *Enforcement*

As the Model Rule is part of law society regulation to which lawyers are subject as members of the profession in Canada, existing audit, review, investigation and disciplinary functions within each law society apply. Breaches of the Model Rule, as implemented by law societies, will be dealt with as a matter of professional regulation.

Application to Other Jurisdictions

We acknowledge the variable nature of the legal landscape in each jurisdiction, but there may nonetheless be lessons to be learned from the Canadian experience. By voluntarily accepting responsibility to work against money laundering and terrorist financing, independent of government action, law societies have, we suggest, eliminated the need for federal regulation of the legal profession. It is the Federation's view that the Model Rule on client identification effectively meets all the FATF requirements, while respecting the sanctity of the solicitor-client relationship and independence of the bar. Similarly, by eliminating the use of large amounts of cash in a lawyer's practice, the No Cash Rule has removed the opportunity for a client to enlist a lawyer or notary (openly or otherwise) in an illegal scheme to launder money.

In our view, self-regulation in these areas is consistent with the best traditions of regulation of the profession. At its most basic level, the role of a law society is to regulate lawyers in the public interest. Preventing lawyers through appropriate law society regulation from assisting, knowingly or otherwise, any money-laundering activity, and responding strongly to breaches of regulation promotes the public interest.

Additionally, the Federation has consistently stressed the importance of the independence of the bar. A bar free from the interference of State authorities is a critical component of the Rule of Law. Members of the public must have confidence in a system of justice that provides them with legal counsel who are free from the influence of the State.

In Canada, there is clear case commentary on the issue. In a recent decision the Supreme Court of Canada held

“An independent bar composed of lawyers who are free of influence by public authorities is an important component of the fundamental legal framework of Canadian society. In Canada, our tradition of allowing the legal profession to regulate itself can largely be attributed to a concern

for protecting that independence and to lawyers' own staunch defence of their autonomy."⁹

Independence of the bar is an important principle to be protected and promoted. This is a critical strength of our profession, and by advocating whenever appropriate the principle is reinforced.

Know Your Client Regulation—Has It Gone Too Far?

The Federation supports know your client regulation in principle and recognizes it as both necessary and appropriate. Law societies in Canada are implementing regulations in this area as part of their duty to act in the public interest.

It is important, however, that such regulation not go farther than is necessary. Regulation that requires information to be gathered for the sole purpose of making it available for inspection of the State goes too far. In our view information should be gathered only when necessary in the context of the solicitor-client relationship and only when consistent with our ethical obligations to prevent crime.

A Final Point

At this time, FATF would seem to strongly promote a risk-based approach to the detection of possible money-laundering activity. After much consultation, comprehensive guidance for the legal profession was published in October, 2008 and can be found on the FATF website. It discusses throughout a system that relies on education of the profession and careful consideration of the particulars of every retainer to determine the risk. It speaks of dangers associated with a particular type of client, a country of origin, or the nature of the transaction.

The current regulation does not do this. Little consideration is given to the particular risks a client or their transaction may present. This might be seen by some to suggest the current Know Your Client regulation does go too far, or, better stated, goes in a different direction.

It is acknowledged, however, that a true risk-based approach may well be resource intensive, especially during introduction, and therefore not as practical as current models. Yet while current rules require lawyers to cease acting when they have reason to believe they are assisting a crime, little guidance is given to these same lawyers to assist in these determinations. It may be argued that Governments and perhaps FATF assessors have been so focused on ensuring the promulgation of regulatory regimes that this important guidance has been neglected, and it is in this direction that efforts should now be made.

In that respect, some might well say that Know Your Client regulation has gone too far.

9. *Finney v. Barreau du Québec*, 2004 SCC 36 (CanLII), available at <http://www.canlii.org/en/ca/scc/doc/2004/2004scc36/2004scc36.html>.