

COMPLYING WITH THE NEW CLIENT IDENTIFICATION AND VERIFICATION OF IDENTITY REQUIREMENTS OF BY-LAW 7.1

BACKGROUND INFORMATION ON THE NEW REQUIREMENT

Lawyers by virtue of their trust accounts are targets for those wishing to launder money. Amendments to By-Law 7.1 on client identification and verification were approved by Convocation on April 24, 2008 and come into effect on December 31, 2008. These amendments are contained in Sections 20 – 27 of the By-Law. The new requirements are based on a Model Rule developed by the Federation of Law Societies of Canada as a part of its initiative to fight fraud. Law Societies across Canada are in the process of implementing the Model Rule within their regulatory regimes to create a national, uniform standard for client identification and verification requirements.

MONEY LAUNDERING AND TERRORIST FINANCING

By way of background, as a result of growing global concern in 2000, the Government of Canada passed legislation known as the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (the “Act”). Under the Act, regulated persons and entities are required to report suspicious transactions and certain other financial transactions. Reporting persons are prohibited from “tipping off” their client about having made the report. Despite concerns expressed by the Federation of Law Societies, in November 2001 the federal government promulgated Regulations making the Act applicable to lawyers and requiring legal counsel to secretly report suspicious transactions to the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC), a federal agency. The Federation and the Law Society of British Columbia, supported by the Canadian Bar Association, initiated proceedings in the Supreme Court of British Columbia challenging the constitutionality of the legislation and seeking interlocutory relief from the application of the Regulations to legal counsel. The Federation contended that the legislation required lawyers to act as secret agents of the state, collecting information about clients against their interests and reporting to a government agency. The Supreme Court of British Columbia agreed with these concerns and granted an interim injunction such that legal counsel were not required to report “suspicious transactions” pending a full hearing on the merits of the case. The BC Court of Appeal and the Supreme Court of Canada denied the government’s application for a stay of the Order. 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 Quebec notaries), pending a final decision on the merits of the constitutional challenge to the legislation. The hearing of the challenge has now been adjourned generally, and all lawyers in Canada remain exempt from the legislation by virtue of the injunction. 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 interim the Federation independently of the litigation, has launched its own initiatives to fight fraud.

NO- CASH RULE

In 2004, the Federation adopted a “No-Cash” Model Rule. All Law Societies across Canada have implemented rules restricting lawyers from receiving cash in amounts of \$7,500.00 or more. The adoption of the No-Cash Rule rendered unnecessary the obligation under the *Act* that the federal government sought to impose on lawyers, to report transactions involving \$10,000.00 or more in cash.

BILL C-25

In October 2006, the federal government introduced Bill C-25 that made a series of amendments to the *Act*. Bill C-25 includes provisions (sections 6 and 6.1) enhancing the client identification, recordkeeping and reporting requirements in the *Act*. In June 2007, new client identification and verification regulations under these provisions were published by the Department of Finance. The regulations purport to regulate how lawyers and others should identify and verify the identity of clients. The regulations were published in final form in December 2007 and with respect to the legal profession, come into force in December 2008. Attached is a summary of the Regulations as applicable to lawyers. However, the injunction discussed earlier states that any new regulations do not apply to the legal profession unless the Federation of Law Societies consents.

The Federation’s Model Rule on Client Identification and Verification in many respects codifies the steps that a prudent lawyer would take in the normal course to verify a client’s identity. The Model Rule respects the threshold between constitutional and unconstitutional requirements imposed on lawyers when it comes to gathering information from clients: a lawyer 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. Like the adoption of the No-Cash Rule, national implementation of the Model Rule on Client Identification and Verification will demonstrate that responsible self-governance by the law societies makes federal regulation of the legal profession on this subject matter unnecessary.

NEW FEDERAL REGULATIONS ON CLIENT IDENTIFICATION AND VERIFICATION AS APPLICABLE TO LAWYERS⁸

The following is a summary of the obligations of lawyers under the Federal Regulations on Client Identification and Verification published in final form in December 2007. The injunction discussed earlier states that any new regulations do not apply to the legal profession unless the Federation of Law Societies consents.

1. CLIENT IDENTIFICATION AND VERIFICATION

The new Regulations require a lawyer to identify a client whenever the lawyer receives \$3,000 or more in the course of the lawyer's business activities. Funds received from a public body or a publicly-traded company with minimum net assets of \$75 million and which is located in a country that is a member of the FATF are exempt. The new Regulations also exempt lawyers from the requirements when the funds are received by the lawyer from the trust account of another lawyer.

Individual clients must be identified by referring to a government-issued identification document (e.g. a birth certificate, driver's license, provincial health insurance card, passport or similar document). If the client is an organization, the lawyer must rely on identifying documents such as a certificate of corporate status, trust or partnership agreements and articles of association. The new Regulations require additional identification procedures where the client who is an individual is not physically present, and permit the identification to be done by an agent or mandatary. For such non-face-to-face situations, the Regulations require combinations of two methods of identification set out in Schedule 7. For example, an attestation by a commissioner of oaths in Canada about the identity of the person and reference to identifying information in a credit file on the person would suffice.

Information required to be obtained during the identification process includes:

⁸ The new regulations relevant to the legal profession include provisions from:

- the *Proceeds of Crime (Money Laundering) and Terrorist Financing Regulations*, Registration SOR/2002-184, May 9, 2002,
- amendments to those Regulations made by *Regulations Amending Certain Regulations Made Under the Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (2007-1) Registration SOR/2007-122 June 7, 2007 (published in Part II of the *Canada Gazette*, June 27, 2007), which generally come into force on June 23, 2008,
- amendments to those Regulations made by *Regulations Amending Certain Regulations Made Under The Proceeds Of Crime (Money Laundering) And Terrorist Financing Act* (2007-2) published in Part II of the *Canada Gazette* on December 26, 2007 as SOR/2007-293, December 13, 2007, and
- amendments to those Regulations made by *Regulations Amending Certain Regulations Made Under The Proceeds Of Crime (Money Laundering) And Terrorist Financing Act* (2008-1) published in Part II of the *Canada Gazette* on February 20, 2008 as SOR/2008-21, January 31, 2008.

- (a) For a client who is an individual, the name, address and date of birth of the person;
- (b) For a client that is a corporation, the corporate name and address and the name of its directors. “Reasonable efforts” must be made to obtain the occupation of its directors and the name, address and occupation of any person who owns or control 25% or more of the corporation;
- (c) For a client that is an entity other than a corporation, confirmation of its existence. The same reasonable efforts must be made to obtain the name, address and occupation of any person who owns or control 25% or more of the entity.

The new Regulations require the lawyer to document the inability to obtain through the “reasonable efforts” the specified information in b. and c.

When confirming the existence of a not-for-profit organization, a lawyer must determine whether it is a registered charity or solicits charitable financial donations.

For corporations or other organizations, the verification (the existence of the organization) must be confirmed within 30 days of the transaction. Individual clients’ identity must be confirmed at the time of the transaction.

Under the new Regulations, a lawyer is not required to re-identify clients unless he or she has doubts about the veracity of the previously obtained client information.

2. RECORD KEEPING

The new Regulations include very detailed record-keeping requirements. Various records, described below, must be kept for a period of five years.

A lawyer must keep a “receipt of funds record”, a defined term in the new Regulations, when he or she has received \$3000 or more, except when the funds are received from a financial institution or public body. While parts of this record may already exist within a law office, it must include the following information:

- name, address and birth date of the person providing the funds,
- if the client is a person, the nature of the person’s principal business or occupation,
- if the client is an organization, the address and nature of the organization’s principal business,
- date of the transaction,
- account number affected by the transaction,
- type of account,
- full name of the person or entity who holds the account,
- monetary currency of the transaction,
- purpose and details of the transaction,
- if cash is received, how the funds are received, and
- amount and currency of the funds received.

If the client is a corporation, a lawyer must also include with the receipt of funds record a copy of the part of the official corporate records that contains any provisions relating to the power to bind the corporation in respect of the transactions with the lawyer.

The new Regulations indicate that the receipt of funds record is to contain the information specified if the information is not readily obtainable from other records that the lawyer keeps under the Regulations.

The new Regulations exempt lawyers from this record keeping requirement when the funds are received by the lawyer from the trust account of another lawyer. In such cases the lawyer must keep a record of that fact and is not required to include in the receipt of funds record the number and type of the account affected by the transaction or the name of the person or organization who holds the account.

For identification of an individual, a lawyer must keep a record of the following information or keep the required document, as the case may be, which information relates to the methods required under the new Regulations for individual identity verification:

- ❑ for the birth certificate, driver's license, provincial health insurance card, passport or similar document, the type and reference number of the record and the place issued;
- ❑ with respect to the methods described in Schedule 7,
 - for the cleared cheque, the name of the financial entity and account number,
 - for confirmation of the deposit account, the name of the financial entity, number of the account and the date of the confirmation,
 - for the identification product, its name, the entity offering it, the search reference number and the date it was used to ascertain identity,
 - for the credit file, the name of the company and date consulted,
 - for the attestation, the attestation.

For corporate identity, where the identifying document is in electronic form, a lawyer must keep a record that sets out the corporation's registration number, the type of record referred to and the source of the electronic version of the record (a similar record is required for other organizations). Where the above information has been ascertained by referring to a paper copy of a record, a lawyer must keep the record or a copy of it.

At the time the existence of an organization is confirmed, if the lawyer has obtained the information about direct or indirect ownership and control described above, he or she must record it. As discussed earlier, where the lawyer is unable to obtain the above information, he or she must keep a record of the reasons the information could not be obtained.

Where the entity is a not-for-profit organization a lawyer must keep a record of whether it is a registered charity or solicits charitable financial donations.

The records required under the new Regulations must be kept in a form that can be provided to an authorized person within 30 days after a request is made to examine

them under section 62 of the Act. Section 62 gives FINTRAC authority to examine records of those who are subject to the Regulations.⁹

Note on Sections 62 to 65.1 of the Act

These sections effectively authorize warrantless searches of law offices for the purpose of ensuring compliance with the Regulations. The sections are based on *Criminal Code* provisions that have been struck down as unconstitutional by the Supreme Court of Canada. As such, these sections do not comply with the stringent requirements established by the Court in *Lavallee, Rackel & Heintz v. Canada*.¹⁰ Bill C-25, amending legislation in respect of the Act, which received Royal Assent in December 2006, did not include amendments to sections 62 to 65 to address this issue despite the apparent intention of the Department of Finance to do so. The following appeared in the Department's June 2005 consultation paper, referenced earlier:

6.17 Documents Protected by Solicitor-Client Privilege

Reference: PCMLTFA, sections 62 to 65

Amendment

Amend the compliance provisions that allow FINTRAC to examine documents to bring the PCMLTFA into conformity with the principles set out by the Supreme Court of Canada in its decision in the case of *Lavallee, Rackel & Heintz* in respect of solicitor-client privilege.

Explanation

⁹ Section 62 of the Act reads:

- 62.** (1) An authorized person may, from time to time, examine the records and inquire into the business and affairs of any person or entity referred to in section 5 for the purpose of ensuring compliance with Part 1, and for that purpose may
- (a) at any reasonable time, enter any premises, other than a dwelling-house, in which the authorized person believes, on reasonable grounds, that there are records relevant to ensuring compliance with Part 1;
 - (b) use or cause to be used any computer system or data processing system in the premises to examine any data contained in or available to the system;
 - (c) reproduce any record, or cause it to be reproduced from the data, in the form of a printout or other intelligible output and remove the printout or other output for examination or copying; and
 - (d) use or cause to be used any copying equipment in the premises to make copies of any record.

Assistance to Centre

(2) The owner or person in charge of premises referred to in subsection (1) and every person found there shall give the authorized person all reasonable assistance to enable them to carry out their responsibilities and shall furnish them with any information with respect to the administration of Part 1 or the regulations under it that they may reasonably require.

¹⁰ *Lavallee, Rackel & Heintz v. Canada (Attorney General)*; *White, Ottenheimer & Baker v. Canada (Attorney General)*; *R. v. Fink*, [2002] 3 S.C.R. 209.

In a 2002 decision in the case of *Lavallee, Rackel & Heintz*, the Supreme Court of Canada set out principles that should be followed to protect solicitor-client privilege when the police seize documents from law offices under warrants. The proposed amendments would ensure that the compliance provisions under the PCMLTFA allowing FINTRAC to examine documents are consistent with these principles.

The Federation of Law Societies of Canada, in its responding to the consultation paper in September 2005, affirmed the need to address this issue:

The Federation supports the proposal in section 6.17 of the Consultation Paper to amend sections 62 to 65 of the Act to conform with the principles established by the Supreme Court of Canada on seizure of solicitor and client privileged documents. These sections are modeled closely on those in the *Criminal Code*, which have been struck down as unconstitutional by the Supreme Court. The Court, in confirming that privilege does not come into being by an assertion of a privilege claim, but exists independently, found that by the operation of s. 488.1 of the *Criminal Code*, the “constitutionally protected right” of privilege could be violated by the mere failure of counsel to act, without instruction from or communication with the client. The Federation agrees that the Act must be amended to ensure that solicitor and client privilege is protected.

The application of sections 62 to 65.1 as currently framed in the Act to the legal profession would create serious problems for the protection of solicitor and client privilege and confidentiality.

3. COMPLIANCE

The new Regulations require lawyers or law firms to establish detailed compliance and review programs. The following is an overview of the requirements.

A lawyer or law practice must implement a program to ensure compliance with the new Regulations by:

- ❑ designating a person in the law practice – who, where the program is being implemented by a person, may be that person (e.g. a sole practitioner) – who is to be responsible for the implementation of the program;
- ❑ developing and applying written compliance policies and procedures that are approved by the law practice’s managing partner, as the case may be, and are kept up to date;
- ❑ assessing and documenting, in a manner that is appropriate for a law practice, the risk of money laundering or terrorist financing, taking into consideration
 - the clients and the business relationships of the law practice,
 - the services and service delivery methods of the law practice,
 - the geographic location of the activities of the lawyer, and

- any other relevant factor;
- if the law practice has employees, agents or other persons authorized to act on its behalf, developing and maintaining a written ongoing compliance training program for those employees, agents or persons;
- instituting and documenting a review of the policies and procedures, the risk assessment and the training program for the purpose of testing their effectiveness, which review is required to be carried out every two years by an internal or external auditor of law practice, or by the law practice itself if it does not have such an auditor.

For the purposes of the compliance program, the law practice must report the following in written form to the managing partner, as the case may be, 30 days after the assessment described above:

- the findings of the review referred to in e above;
- any updates to the policies and procedures made within the reporting period; and
- the status of the implementation of those policies and procedures and their updates.

If a law practice considers the risk of money laundering or terrorist financing in the course of its activities to be high, the lawyer or law practice must develop and apply written policies and procedures for taking reasonable measures to keep client identification information up to date and mitigating the risks.