

‘CLOSING THE GAPS’: NEW DRAFT REGULATIONS BRING LAWYERS UNDER THE PURVIEW OF TERRORIST FINANCING LAWS

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A. INTRODUCTION

From the inception of Canada’s post 9/11 anti-terrorism legislative regime, it has been apparent that the federal government has intended that lawyers be subject to responsibilities under terrorist financing legislation. However, because of an outcry from the legal community and a subsequent court challenge, the legal profession was at least temporarily exempt from the most invasive requirements of Canada’s terrorist financing laws. The proposed “Regulations Amending Certain Regulations Made Under the Proceeds of Crime (Money Laundering) and Terrorist Financing Act (2007-2)” [“Draft Regulations”] that were published on June 30, 2007, is the most recent initiative by the federal government to bring legal counsel under the direct purview of terrorist financing obligations.¹

The perceived need for the Draft Regulations was made clear by the Department of Finance when it stated that the legal profession is a “potential conduit” for terrorist financing activity. The Department of Finance also emphasized that the Draft Regulations are an essential step in “closing the gaps” in Canada anti-terrorist financing regime as section of the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* may now apply to lawyers.² If adopted, the impact of the Draft Regulations will be felt throughout the legal

¹ Canada Gazette, “Regulations Amending Certain Regulations Made Under the Proceeds of Crime (Money Laundering) and Terrorist Financing Act (2007-2)” at <http://gazetteducanada.gc.ca/part1/2007/20070630/html/regle6-e.html>

² Canada Gazette, “Regulatory Impact Analysis Statement” <http://gazetteducanada.gc.ca/part1/2007/20070630/html/regle5-e.html>

community and will necessitate a restructuring of legal counsel's procedures concerning advising clients on monetary transactions and the development of internal anti-terrorism due diligence procedures.

B. THE *PROCEEDS OF CRIME ACT* AND THE LEGAL PROFESSION

The *Proceeds of Crime (Money Laundering) Act* was originally enacted to combat organized crime. After the events of September 11, 2001, it was amended through Part 4 of the *Anti-terrorism Act*³, which expanded its scope to include terrorist financing. The amended *Act* was renamed the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* ["*Proceeds of Crime Act*"].⁴ The original regulations were adopted under the amended *Proceeds of Crime Act* and promulgated on May 9th, 2002.

The federal government had previously repealed the application of the *Proceeds of Crime Act* to the legal profession in response to concerns from the legal community and a constitutional challenge brought by the Federation of Law Societies of Canada. The primary concern for the legal profession at the outset was the threat to the independence of the Bar by requiring lawyers to secretly report confidential client information to the government with respect to suspicious transactions, and to report large cash transactions to the Financial Transactions and Reports Analysis Centre of Canada ["FINTRAC"].⁵

Negotiations between the Department of Finance and the legal profession have been ongoing since 2002 in order to develop a mutually acceptable regime of reporting and due diligence procedures. In May 2005, the matter between the Federation of Law Societies of Canada and the Attorney General of Canada was adjourned *sine die* (without any future date being designated for resumption) and upon a number of conditions by the British Columbia Supreme Court.⁶

³ S.C. 2001, c. 41. 41 ["*Anti-terrorism Act*"].

⁴ For more information concerning the *Proceeds of Crime Act*, see "The What, Where and When of Anti-Terrorism Legislation for Charities in the International Context" available at <http://www.carters.ca/pub/article/charity/2006/tsc05111.pdf>

⁵ The Law Society of British Columbia, "What's New" <http://www.lawsociety.bc.ca/utilities/whatsnew.html>

⁶ *Federation of Law Societies of Canada v. Attorney General of Canada* (British Columbia Supreme Court, Vancouver Registry No. L013117, 13 May 2005). The conditions include the following:

1. That if a new set of regulations affecting legal counsel is enacted pursuant to the *Proceeds of Crime Act* by the Federal Government without the consent of the Federation, that the coming into force of those regulations would be deferred in accordance with the May 2002 Agreement between the Federation and the Attorney General of Canada;
2. That the Attorney General of Canada agree to interlocutory injunctions exempting legal counsel and legal firms from the application of the Act and its Regulations should it become necessary to maintain the status quo at any stage of the proceedings; and
3. That the Federation and the Attorney General have an unrestricted right to re-set the petition for hearing.

In December 2006, Bill C-25 *An Act to amend the Proceeds of Crime (Money Laundering) and Terrorist Financing Act and the Income Tax Act and to make a consequential amendment to another Act* [“Bill C-25”] received Royal Assent.⁷ The amendments to the *Proceeds of Crime Act* by Bill C-25 confirmed that lawyers were exempt from reporting obligations under the *Act*.

The potential scope of obligations and liability, however, under the *Proceeds of Crime Act* is sweeping and is not confined to reporting obligations. It was not perhaps unexpected that in June of this year, that the Department of Finance published the Draft Regulations that propose to recruit the legal profession to participate in the federal anti-terrorist financing initiative while being careful to avoid overtly requiring counsel to be subject to reporting obligations.

C. ‘CLOSING THE GAP’: THE DRAFT REGULATIONS

The importance of the Draft Regulations to the federal government and its determination to see the legal profession brought under the purview of terrorist financing regulations cannot be understated. The Department of Finance was clear in its “Regulatory Impact Analysis Statement” [“Impact Statement”] that accompanied the publication of the Draft Regulations, the legal profession is one of the final sectors that it intends to bring within the purview of the *Proceeds of Crime Act* and thus “closing the gaps” in Canada’s anti-terrorist financing regime.⁸ In addition, the Draft Regulations could be adopted as soon as the fall of this year as they are only subject to a 60-day consultation period, which comes to a close on August 29, 2007.

The Department of Finance, in response to its obligation not to subject the legal profession to reporting requirements, has proposed to require that lawyers meet the client identification and record-keeping requirements under Part 1 of the *Act*. Under the Draft Regulations, lawyers will be required to carry out procedures for confirming the identity of certain clients and to undertake risk assessments to assess the risk of being utilized by clients for terrorist financing.

The responsibilities of legal counsel and legal firms under the Draft Regulations would be generally triggered whenever counsel, on behalf of a client, engages in or give instructions in respect of “receiving or paying funds, other than those received or paid in respect of professional fees, disbursements, expenses or bail”

⁷ For more information about Bill C-25 and its impact on charities, see *Anti-terrorism and Charity Law Bulletin No. 12* available at <http://www.carters.ca/pub/alert/ATCLA/ATCLA12.pdf>

⁸ *Supra*, note 1.

unless the amount is received through a financial entity or public body. Though the language of this portion of the Draft Regulations is vague, presumably this would mean that responsibilities under the *Act* could apply when counsel is involved in a variety of activities including: the purchase or sale of property; receiving or dispersing of judgments and/or settlement funds; or the administration of an estate.

The Department of Finance stressed in its Impact Statement that it consulted with “professional associations” at certain stages of the development of the Draft Regulations over the past few years. However, in describing the various sources for the actual recommendations that are implemented in the Draft Regulations, the Impact Statement credits “several of the federal partners to the regime” including the RCMP and the Canada Revenue Agency.

The enforcement and penalties of the Draft Regulations range from being asked to complete questionnaires, on-site investigations by FINTRAC, financial penalties of up to \$500,000 under the *Proceeds of Crime Act*, and punishment under the *Criminal Code*. The on-site investigation raises the possibility of a threat to solicitor-client privilege that may arise from the prospect of a government agency with oversight being able to audit lawyer’s internal compliance procedures.⁹ Furthermore, investigations under the *Proceeds of Crime Act* could lead to an investigation under the broad scope of the *Criminal Code* facilitation of terrorist activities provision. Even an investigation based on the suspicion of a terrorist activity facilitation offence could – at the very least - result in the freezing or seizure of the assets of a lawyer or law firm, actions which would cripple a practice for months or even years.

D. NEW COMPLIANCE REGIME AND DUE DILIGENCE BURDEN

If adopted, the Draft Regulations would have significant implications for how lawyers conduct their practice in order to implement the strict client verification, risk assessments and record keeping procedures. The Department of Finance’s Impact Statement recognizes that the practical implications of the Draft Regulations for lawyers and law firms would include conducting a risk assessment as to the “vulnerabilities” to be used for terrorist financing of the law firm, training employees on the implementation of anti-terrorist financing policies and appointing a compliance officer.

⁹ Cristin Schmitz, Lawyers Weekly “Lawyers and government spar over new money-laundering rules” Vol. 27, No. 12, July 20, 2007.

It is important to note that even without the adoption of the Draft Regulations, legal counsel and their clients are already subject to scrutiny under the *Proceeds of Crime Act*. Under the *Act*, all financial institutions that actually process and carry out any monetary transactions are already responsible to report certain transactions to FINTRAC, confirming the identities of the parties and analyzing the transaction for any signs of activity that would raise suspicions about terrorist financing.

E. CONCLUSION

If the Draft Regulations are adopted in their current form, it could significantly alter the dynamics of the lawyer-client relationship. Anti-terrorist financing and money laundering due diligence procedures for accepting clients and acting on behalf of them - especially when the matter involves advising on or transferring funds - will likely not be a matter of prudence, but one of operational necessity.

Considering that there is an already significant anti-terrorism due diligence burden on lawyers under anti-terrorism legislation separate from *Proceeds of Crime Act*, there will be an increasing urgency for lawyers and law firms to develop their own internal anti-terrorism due diligence procedures that will facilitate compliance with the burgeoning legislative and regulatory responsibilities.