Memo

The Law Society of British Columbia

To The Benchers

From The Executive Committee

Date April 25, 2013

Subject **Rules Concerning Trust and Other Client Property – Lawyers Acting as Attorneys and Executors**

I. Introduction

This matter was brought to the attention of the Executive Committee by Ms. Berge, arising from concerns, as discussed below, expressed to her from members of the Bar in Victoria. The matter has now been considered by the Executive Committee at its meetings of October 16, 2012 and April 25, 2013. The Committee also placed an earlier memorandum explaining the issue, prepared by Ms. Berge and Mr. Lucas, before the Benchers for information only at the Benchers' October 26, 2012 meeting. The matter is now placed before the Benchers with a recommendation for approval in principle to amend the rules to address the concerns as identified, and to then refer the matter to the Act and Rules Subcommittee.

Preliminary draft rules are appended to the memorandum to give a sense as to what rule changes will be necessary, but they will need further consideration by the Act and Rules Subcommittee before being returned to the Benchers for approval.

II. Identification of the Problem Under Examination

Lawyers who act as a personal representative of a person where the appointment is derived from a solicitor-client relationship (such as an executor under a will, an attorney under a power of attorney, or as a trustee), have identified concerns about the current trust rules and how they can adversely affect such representations. These concerns have been raised directly with Law Society trust auditors, and have been of particular concern to a segment of the Victoria Bar. This matter was raised by Ms. Berge with the Executive Committee. The Committee suggested that further exploration of the underlying policy issues be examined.

The Trust Department, when conducting audits of law firms, has also noted a tension arising amongst those members practicing in the wills and estates area who are often asked to act as such fiduciaries, and who, quite properly, strive to practice within the Rules while endeavouring to meet their full fiduciary relationship to their clients. The Trust Department has also noticed that the Trust Rules are not always complied with where a lawyer-fiduciary is acting other than in a traditional solicitor-client role.

When handling trust funds, lawyers must operate under specific obligations set out in Division 7, Part 3 of the Law Society Rules (the "Trust Rules"). "Trust Funds" are defined in Rule 1 to include

> ...funds received in trust by a lawyer acting
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> (b) as a personal representative of a person or at the request of a person, or as a trustee under a trust established by a person, if the lawyer's appointment derived from a solicitor-client relationship;

Even if a lawyer is acting *qua* "personal representative in circumstances where his or her appointment is derived from a solicitor-client relationship" rather than *qua* lawyer, the funds received are "trust funds" and must be dealt with under the Trust Rules. This result raises difficulties in the administration of the responsibilities assumed by the lawyer. These are explained below.

This memorandum examines policy considerations surrounding the Trust Rules insofar as they relate to relationships where the lawyer is not acting as a lawyer but does have fiduciary responsibilities. It will consider whether the handling of trust funds and other client valuables in those situations may allow for some different considerations from those currently set out in the Trust Rules, which really address considerations where the lawyer is acting as a lawyer only and not in a general fiduciary capacity.

The possibility of a new rule governing the handling of funds and client property where the lawyer is not acting as a lawyer but is a fiduciary/personal representative arising from a solicitor-client relationship will be considered.

III. Background

When reviewing and considering the trust rules in the early 2000s, the Trust Assurance Reform Task Force recognized that, in order to protect the public interest, it was important that it be clear that lawyers must properly handle and account for funds and valuables handled by them in circumstances where the lawyer was acting as a "personal

representative" (such as a trustee or a fiduciary) even if the relationship was not that of lawyer-client – and especially so where the relationship arose from the lawyer having acted for a client.

Therefore, where a lawyer was (for example) appointed executor over a client's estate arising from circumstances where the lawyer had advised the client on legal matters and the client trusted the lawyer as a professional advisor, the Task Force considered it was important that the lawyer account for the funds of the estate as "trust funds" even though the lawyer was now acting *qua* executor rather than *qua* lawyer. Equally, where a client appointed a lawyer as his or her attorney under a power of attorney to handle part or all of the client's assets either permanently or temporarily, the Task Force concluded that lawyers must account for these assets in accordance with the Trust Rules. Moreover, such appointments must be disclosed on the lawyer's Trust Report and be subject to audit, as required.

In large part, the Task Force believed such reporting and handling of the funds and client property was necessary because, should the lawyer ever abscond with the funds, the Special Compensation Fund (now Part B Insurance) could be liable. Ensuring that an audit trail existed was therefore a prudent and necessary consideration to protect the public interest.

To be clear, the Trust Rules only apply where the trustee or fiduciary relationship arises from a solicitor-client relationship. Lawyers acting as a personal representative are not governed by the Trust Rules if the underlying relationship did not arise from a solicitor-client relationship, but instead arose from, for example, familial responsibilities or where the lawyer was appointed because he or she was a long-standing friend of the testator or donor. Nor is the lawyer, in those circumstances, required to disclose that relationship on his or her Trust Report. However, even in these situations lawyers, like all fiduciaries, are still required to account for the property handled in accordance with other legislation (such as the *Trustee Act*, the *Power of Attorney Act* or the *Estate Administration Act*) or pursuant to the laws of equity.

It is unknown exactly how widespread problems arising from the operation of the current Trust Rules are for lawyers acting as personal representatives, because the current rules have been in place for almost a decade and until recently no real concerns had been raised. However, concerns, as discussed below, have been identified, and it would be wise to give some policy consideration to them.

IV. Issues

The current requirements under the Trust Rules set out very specific obligations on how "trust funds" must be handled. Specifically, for example, such funds must be deposited in designated savings institutions. Funds may only be paid out by cheque. No automatic withdrawals are permitted. Therefore, if a lawyer is acting as a personal representative with fiduciary responsibilities where the appointment was derived from a solicitor-client relationship, the lawyer may be obligated, in accordance with the Trust Rules, to redesignate the accounts as trust accounts in the lawyer's name, which may not be what the beneficiary desires nor may it be in the beneficiary's best interests. In some cases, if the accounts are held in unusual ways (perhaps in off-shore accounts), the lawyer may be required to cash in all the accounts and re-deposit them in accounts that accord with those permitted by the Rules. This could have significant consequences. For example, if the lawyer is acting as a temporary Attorney for a client during a client's absence from the country, it is doubtful that the client will want the lawyer to have to cash in all existing securities accounts, although this could be required on a strict reading of the current rules.

Equally, acting as an executor, it may be advantageous from an estate's point of view to leave the funds of the estate in the accounts of the testator pre-existing death. For example, the executor may find it as easy to allow automatic withdrawals to continue to pay utility bills than to change account instructions and have to write cheques, as the Trust Rules would require. Alternatively, for the estate's accounting purposes, it may be advantageous to pay estate expenses directly through the bank or maintain lucrative investments in an investment account that provides the possibility of much greater income than that which can be earned from a pooled trust account or an interest-bearing investment account.

If a lawyer is appointed as an attorney for his or her client and the client later becomes incapacitated, the standard approach is that the lawyer proceeds to administer the client's assets in more or less the same, or similar, form as the investments were in at the time that the lawyer-attorney assumes his or her responsibilities: Investments and bank accounts are left intact, mortgages and other obligations paid from them and the funds are not liquidated and placed in the lawyer's pooled trust. In many instances the client is a minor or disabled person and is expected to live many years into the future or the estate may take some years to administer; liquidation of all assets to convert into pooled trust, or interest-bearing trust, is not necessarily considered a prudent investment. Maintenance of the security of the client's assets and income for the benefit of the client him or herself,

or heirs, is considered the first responsibility of the lawyer-fiduciary acting as a personal representative.

Further, a lawyer acting under a power of attorney or as an executor may, directly or indirectly, maintain control of the client's real estate investments in order to allow the estate to earn income, the client's children to benefit from the use of the real estate assets, or to plan for development or other investment in the land. Real estate is not a permitted investment in a pooled trust account under the Trust Rules.

All these examples raise issues with the application of the current Trust Rules to situations where a lawyer is acting as a fiduciary from an appointment arising out of a solicitor–client relationship.

V. Policy Considerations

1. General considerations

When lawyers are handling funds or property where the lawyer has been appointed as personal representative deriving from a solicitor-client relationship, the Law Society Rules ought to address how the funds and property are handled and accounted for. Lawyers are respected professionals and the public places a high level of trust in them. The assets should be handled and accounted for with the integrity expected of a lawyer, even if the lawyer is not performing solicitor-client functions in connection with the appointment. Lawyers handling property or trust funds in these circumstances should still be expected to be subject to audit by the Law Society with respect to their handling of the trust funds or property in the course of discharging obligations as a personal representative. Simply put, the lawyer has been appointed because of a past relationship that the lawyer and person making the appointment have had. It is reasonable to view the lawyer as a member of a regulated profession, and expect that the lawyer is handling the assets as a member of a regulated profession, even though the lawyer's principle function is as some other type of fiduciary.

Moreover, the Compulsory Professional Liability Insurance Policy, through Part B, now covers dishonest appropriation of money or other property that was entrusted and received by a lawyer in his or her capacity as a barrister and solicitor and in relation to the provision of professional services in certain circumstances. Dishonest appropriation by a lawyer acting as a personal representative deriving from a solicitor-client relationship may be covered through Part B. In order to be able to properly address claims under Part B, it is important for the Law Society to ensure that funds that may be

the subject of a claim are accounted for as "trust funds." This protects both the public and the Law Society itself.

2. Specific considerations

The current Trust Rules, insofar as they relate to "trust funds" focus on "funds" that are received by a lawyer as a retainer or in the course of the retainer, such as settlement funds, or sale proceeds. These are particular funds that come into existence arising from a specific, or a series of specific, matters. While they may be held by the lawyer for a period of time, the lawyer's principle function is in *holding* the funds, rather than *managing* them.

When acting as a personal representative, though, the trust funds (or other property) may be of a significantly different nature than those received for the purposes of a matter on which a lawyer is acting for a client. Rather than receiving funds in connection with a particular matter, the lawyer may in fact be taking over the *management* of pre-existing assets, such as securities or brokerage accounts.

Recognizing the differing functions that a lawyer has compared to a personal representative, an application of the Trust Rules to funds being held as a personal representative may raise the following considerations:

a. Trust Funds must be deposited to a pooled account and interest must be paid to the Law Foundation.

These requirements may be negated by specific instructions, and therefore should presumably be dealt with by the lawyer before agreeing to the appointment as personal representative. However, it is often likely that this will not be possible. In many situations, many years elapse between the appointment of the lawyer-fiduciary and the date upon which that lawyer takes control of the assets. At the time of the appointment, no detailed discussion may have been undertaken about the Trust Rules and their effect upon income and the overall assets should the lawyer-fiduciary be required to assume control of the client's estate at some later date. Although anecdotal, most appointments of lawyers as attorneys and executors never are acted upon. To obtain detailed instructions regarding an unlikely eventuality is seen to be speculative and uncertain given that the Trust Rules may have changed by the time the attorney or executor controls the client's estate.

Even if such detailed instructions were, however, obtained from each client where such a nomination is made, they are not binding in the event of the client's subsequent loss of capacity, unless provided irrevocably. Obtaining such irrevocable instructions would be unwise due to the likelihood that there will be significant changes in the underlying circumstances of the client in the years that intervene between the appointment and the assumption of responsibilities by the lawyer-fiduciary.

If instructions cannot or have not been received, the Trust Rules prescribe that any funds that the lawyer receives would have to be deposited to a pooled trust account rather than be deposited into an already existing account of the estate that the lawyer is to manage. The interest would accrue to a body external to the trust, which would be contrary to the personal representative's (lawyer's) obligations as a fiduciary.

b. Trust Accounts must be kept in the name of the lawyer or the lawyer's firm and designated as a "trust account."

Where the lawyer is acting as, for example, a temporary attorney under a limited power of attorney, it may make no sense and in fact be contrary to the intention of the donor for the accounts to be renamed and designated "in trust" for any funds that the lawyer was to receive while acting as personal representative (such as where the lawyer is acting under a limited power of attorney to collect rents). All of the concerns identified above apply here; in most instances of longer-term lawyer-fiduciary appointments, these investments are not being held in such accounts.

c. Funds must be held in a designated savings institution.

Unless instructions to the contrary can be received from the client (which in some cases may no longer be possible) some or all of the accounts of the estate handled by the lawyer may have to be converted to a designated savings institution. It may well be prudent for the lawyer, acting as a fiduciary, to make such a change in any event. However, there may be circumstances where the holding of the funds in a non-designated savings institution has been done for a reason, and it would be imprudent to have to cash in the account and re-deposit the funds. The issue should perhaps be addressed on the basis of prudent asset management, rather than adherence to prescribed formulas set out in the Trust Rules.

Even with specific instructions to hold funds in a non-designated savings institution, Rule 3-53 requires a trust account to be in a "savings institution" which is defined in the *Interpretation Act* to mean:

(a) a bank,

(b) a credit union,

(c) an extraprovincial trust corporation authorized to carry on deposit business under the *Financial Institutions Act*,

(d) a corporation that is a subsidiary of a bank and is a loan company to which the *Trust and Loan Companies Act* (Canada) applies, or

(e) the B.C. Community Financial Services Corporation established under the *Community Financial Services Act*;

It is at least conceivable that funds could be held in something that was not a "savings institution" – cash in certain brokerage accounts, for example – in which case even with client instructions a lawyer acting as a personal representative managing assets as a fiduciary could be required under the Trust Rules to deal with the assets in a way not contemplated by his or her appointment.

It is worth noting that "funds" is defined to include coin or bank notes bills of exchange, cheques, drafts, money orders, etc. "Securities" are included in the definition of "valuables" in Rule 3-47 and therefore are not "trust funds." They would have to be accounted for as valuables, but accounts in which securities are held probably escape the application of the rules to "trust accounts" (not defined) which seem to address the holding of "trust funds."

d. Payments or Withdrawals out of a Trust Account

Rule 3-56 permits withdrawals to be made from a trust account only by certain methods and for specific reasons. It is likely that Rule 3-56(a) would cover most situations for payment of funds out of the trust, *provided that* "client" included the donor of the power of attorney, the settlor of the trust, or the testator of an estate, for example. However, if a situation arose where for some reason a payment of funds out of trust by a lawyer acting as a personal representative or executor did not fall within Rule 3-56, the Trust Rules would create problems for the lawyer.

> Equally, funds may only be withdrawn from a trust account by cheque, electronic transfer as permitted by the Rules, by instruction to a savings institution (but only to pay funds to the Law Foundation), or by cash (but only in very specific and unusual circumstances that are not relevant to a normal trust). It may be advantageous for the lawyer, acting as fiduciary, to maintain the donor's previously authorized withdrawals or payments from the account.

What is it that Law Society needs to establish in these sorts of relationships to ensure that it can regulate and, if need be, audit how the lawyer has dealt with the assets? Do the requirements of accounting for trust funds set out in Trust Rules need to be discharged, or is it enough that the lawyer discharges (and is able to show he or she has discharged) general requirements that may be less prescriptive than the specific provisions of the existing Trust Rules, thereby permitting more flexible management of assets but still allowing a proper accounting and, if necessary, audit of the lawyer's activities?

3. Public interest

The public interest is to ensure that when a lawyer is acting either as a lawyer or as a personal representative, where the appointment derives from a solicitor-client relationship, the lawyer will hold trust assets properly and that the client or party appointing the lawyer can be assured that the lawyer's conduct is regulated or at least supervised by the Law Society. A finding of professional misconduct would be expected should a lawyer fail to hold trust funds properly when acting as a lawyer. A finding of conduct unbecoming a lawyer would be available should a lawyer not hold trust funds properly when acting in a capacity other than as a lawyer.

However, if the lawyer, acting as a personal representative where the appointment was derived from a solicitor-client relationship, were required to deal with trust property in a way not contemplated by the appointing party (the client or former client of the lawyer), it is likely that second thoughts would be given to the appointment of a lawyer as a fiduciary. This may not be generally in the public interest, because it may result in the client appointing someone else whose responsibilities are not regulated, or a trust company whose fees (we understand) may be higher.

Moreover, a trust company representative may not be generally expected to have all the same skills or experience as a lawyer, and certainly would not have the same comprehension and familiarity with a client's affairs as would a lawyer appointed as executor or other fiduciary arising out of the solicitor-client relationship. The client would not be expected to have the same degree of trust and confidence in what would,

essentially, amount to a stranger assuming an important fiduciary role in connection with the client's affairs. Ensuring therefore that lawyers remain able to undertake these responsibilities is in the public interest.

On the other hand, public confidence in the legal profession requires that lawyers abide strictly by Law Society regulations concerning the handling of funds entrusted to a lawyer. If the current rules allow the Law Society to best protect the public, then amending the rules to provide different standards for the handling of such funds depending on whether the lawyer was acting *qua* lawyer or *qua* personal representative could be counter-productive to effective regulation. The fact that the rules have been in place a considerable period of time and yet concerns have only been raised in the recent past suggests that lawyers have been able to work with the rules.

4. Member relations

Lawyers should obviously give serious consideration before accepting an appointment as a personal representative, trustee or executor. However, given a lawyer's professional expertise and a general level of trust that may have developed with specific individual clients or former clients, it is to be expected that such appointments will occur and perhaps even be necessary. If so, it would be advisable to ensure that the Trust Rules do not interfere with the fiduciary obligations that a lawyer has undertaken in order that the lawyer is not caught between his or her responsibilities as a fiduciary and his or her obligations to the Law Society.

VI. Options

1. Amend the Rules

A rule amendment to permit a different manner of holding or dealing with funds by a lawyer acting *qua* personal representative could be considered.

There are different ways that this could be accomplished. After consideration, the recommended approach would be to carve out a definition of "trust property" from the current definition of "trust funds." "Trust property" would define funds and valuables received by a lawyer acting as a personal representative of a person or at the request of a person, or as a trustee under a trust established by a person, if a lawyer's appointment is derived from a solicitor-client relationship. In other words, "trust property" would be separately defined from "trust funds," applied to property that a lawyer holds as a

fiduciary from a relationship in which the lawyer is not acting as a lawyer, but where the relationship has been derived from a solicitor-client relationship.

The balance of the trust rules would continue to apply to "trust funds" that a lawyer holds in connection with the solicitor-client relationship. Many of those rules will continue to apply to "trust property" as well. However, some rules would be amended to allow a lawyer to hold or deal with "trust property" in ways more consistent with the trust, thereby relieving the lawyer from some of the applications of the trust rules that may currently prove impractical or even, in some cases, inconsistent with a lawyer's trust obligations, and that gave rise to the tensions that prompted the analysis of this matter.

The application of the rules to trust property can be designed to track the language of the Power of Attorney Regulations under the recently proclaimed *Power of Attorney Act*, creating specific obligations on lawyers concerning the efforts they must make to establish the property and liabilities of the fiduciary obligations and to maintain a list accordingly.

Consequently, rules could be designed to ensure that a lawyer's fiduciary obligations relating to "trust property" would track obligations as established elsewhere in legislation, but still be designed to ensure particular aspects of responsibility necessary to ensure that the lawyer's handling of "trust property" will remain within the purview of the Law Society and be subject to Law Society audits.

A preliminary draft of rules that would effect changes consistent with this recommendation is attached.

2. Leave the Rules in their Current State

The other option is to leave the Rules as they currently read, and to leave it to lawyers to use their good sense in interpreting them insofar as they apply to their handling of trust funds and property where the lawyer is not acting as a lawyer but is acting as a personal representative where the appointment is derived from a solicitor-client relationship. The current rules have been in place for many years and while they do not seen to generate many complaints, the issue appears to be one that is of concern to the wills and estates bar. It has been reported to us that a considerable number of lawyers are appointed as trustees, executors, or attorneys arising out of a solicitor-client relationship.

However, given that concerns have been raised by lawyers engaged in this activity and that an examination as described above identifies that there are some policy

considerations that suggest some problems could arise from the application of the current rules to these situations, leaving the Trust Rules as they are currently drafted may not be a viable option. Providing clarity concerning how funds and property should be handled when acting as a fiduciary but not as a lawyer could be of valuable assistance to lawyers in the Province.

VII. Key Comparisons

The Rules of some other law societies do address this issue to some greater extent than do the rules in British Columbia.

In particular, the Rules of the Law Society of Alberta create a category of lawyer acting "in a representative capacity." Lawyers acting in a representative capacity are exempted from the application of the rule that sets out what a lawyer must do on the receipt of trust money.

VIII. Consultations

The Trust Accounting Department, the Professional Conduct Department and the Lawyers Insurance Fund have been consulted and each has provided information and feedback to the content of this memorandum.

The issue itself was brought to the attention of the Law Society by members practicing in areas of law where a lawyer may be, on occasion, expected to act in a representative capacity as an executor, attorney, or trustee where the appointment has arisen as a result of a solicitor-client relationship. The problems that the current rules are said to create have been identified by those lawyers and expanded on in this memorandum, and this group of lawyers is awaiting a response from the Law Society in connection with the concerns it has raised.

IX. Recommendation

The concerns and issues that have been identified by lawyers practising in areas of law where there is some real likelihood that the lawyer will act in a representative capacity are not speculative and could be problematic, putting lawyers acting in representative fiduciary capacities in conflict with their obligations as a lawyer in handling "trust funds" as defined in the Rules. Consequently, the Executive Committee recommends that rule amendments be approved in principle in the manner of those appended to this memorandum. The Benchers are asked to approve in principle amendments to the rules to address the concerns raised in this memorandum, and to refer the matter to the Act and

Rules Subcommittee to finalize draft rules that can then be returned to the Benchers for consideration and approval.

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