



What is LVTS v. ACSS

& why should you care?

Funds handling in an electronic environment

Like many busy real estate lawyers, Leslie often had a number of stacked transactions closing on the same day, especially at month end. Inevitably, some clients were depending on the proceeds from their sale to help finance the purchase of a new home. And with electronic registration and electronic banking, multiple closings were significantly easier than in the past.

But this lawyer's ability to close a series of transactions on time came to a grinding halt recently: The bank was refusing to certify a cheque for a large purchase transaction closing later that day – because Leslie's trust account was in the red. After some scrambling, Leslie determined that a deposit made remotely by a purchaser's lawyer at another branch of Leslie's bank had been reversed in Leslie's trust account after it failed to clear – leaving the account with insufficient funds for the current, completely unrelated transaction.

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In our hypothetical scenario, Leslie has just learned the first lesson of closing in today's electronic real estate practice: Money you think is in your trust account is not necessarily money that's ready to leave your trust account. Like lawyers across the province, Leslie learned the hard way that it was time to rethink the money-related aspects of closing a real estate transaction.

What is different today?

In the past, the lawyer acting for the purchaser would deliver to the vendor's lawyer (and to the lender's lawyer if there was a private mortgage to be discharged) one or more certified cheques or financial institution drafts, payable in accordance with written directions from the vendor. The parties would meet at a central location – usually the Land Registry Office – to physically exchange funds.

But the advent of electronic registration has created a need to find alternative ways to transfer funds: Without the need to meet personally to exchange and register documents, law offices are seeking alternate ways to transfer funds on closing. The electronic movement of funds for closing to the vendor lawyer's trust account, or direct deposit to a vendor lawyer's trust account at a remote branch of the same bank, are increasingly used as options for streamlining the closing process.

What issues are raised by funds handling in an electronic environment?

At the heart of the issue is the need to be able to verify that funds have cleared or are likely to clear. Clearing of funds is the process of exchanging and reconciling payment items between financial institutions so that funds are transferred from one institution to another – and from someone else's trust account into your trust account – in a final fashion. In other words, has "real value" been received, in a final and irrevocable fashion?

Your ability as a lawyer to verify that you are dealing with cleared funds depends on several factors. First is the issue of the payment system in which the funds are handled: Is it the Large Value Transaction System (LVTS) or the Automated Clearing Settlement System (ACSS)?

If it is the latter – and in fact the majority of funds in Canada are cleared through this system – the lawyer faces a number of other issues. If funds were sent electronically or deposited to your account at a remote branch of the same bank, you may encounter problems verifying the form of funds deposited, and effectively end up taking the risk that the funds may not clear. If there is a shortfall in your trust account because the deposit is reversed and you have disbursed the funds you thought had cleared (or could reasonably have been expected to clear), you will be called on by your own financial institution to make good the shortfall.

Where a remote deposit to your trust account is at issue, your best protection is to determine that the funds deposited were in the form of a certified cheque or a bank draft. As discussed more fully below, even a certified cheque may not clear immediately. If it's a bank draft, you may be concerned about the financial strength and viability of the financial institution on which the funds were drawn. Having said that, in the past real estate practitioners routinely relied on the delivery of certified cheques or bank drafts at traditional, paper-based closings. So long as

you are sure that the deposit to your trust account is in one of these forms, there is likely no appreciable difference in risk in comparison to closings in the past.

As well, although you may expect the funds to move quickly from account to account, financial institutions do not necessarily share this sense of urgency. In most instances funds may not be posted to your trust account until the next business day – and often even later if the other lawyer's financial institution is not one of the major national financial institutions or if a cheque is drawn on an account located in another region of the country.

What is the difference between the LVTS and ACSS systems?

LVTS and ACSS are the two systems operated by the Canadian Payments Association (CPA) to manage the flow of funds within the financial community. The principal difference between the two is in the status of the funds from a "real value" perspective.

FUNDS HANDLING IN LVTS

In LVTS, funds are treated as irrevocable – in other words, deposits to your credit that arrive via LVTS cannot be reversed and may thus be considered as an immediate delivery of "real value".²

All current Canadian dollar wire transfer payments are made through this system.³ Although it is not restricted to large value transactions, as its name suggests the LVTS is primarily used for large transactions. In fact, although only about one percent of all *transaction volume* moves via the LVTS, it accounts for approximately 85 per cent of the *value* of funds moving through the Canadian payment system.⁴ The average value of a LVTS transaction is in the \$8 million range. Those who use the LVTS may pay a fee based on a percentage of monies being transferred, but each financial institution ultimately sets its own pricing structure.

For most residential real estate lawyers, the LVTS is not normally considered a realistic option for the transfer of closing funds. The CPA takes the position that funds are transferred quickly and virtually instantaneously, meaning monies are credited to a recipient's account in a timely way. However, given the reported frequency of funds going "missing" (according to anecdotal evidence), wiring funds seems to bring its own unique difficulties for the lawyers involved. (Presumably the banking community would have a different perspective on this issue.)

It is also worth noting that under LVTS Rule 10, a payment received within three hours of the close of business of the branch may not be available until the start of business on the following day. This applies where an action needs to be taken by the branch to make the funds available to the payee.⁵ The Canadian Bar Association has noted the following:

While the LVTS is designed to operate on a real-time basis, the actual time between giving the payment instruction by the sender and the receiving financial institution confirming that the payment has been received will vary, depending on a number of factors beyond the control of Counsel, and (to a large extent) also beyond the control of the staff of the financial institutions involved in making the transfer.⁶

FUNDS HANDLING IN ACSS

The majority of payments – an average of 18 million or more transactions a day – are cleared through the ACSS system.⁷ It is used for both paper-based payments (cheques) and electronic items, such as pre-authorized debits and direct deposits, that are not LVTS. Not surprisingly, ACSS accounts for 99 per cent of all daily transaction volumes handled by the CPA.

Cheques being cleared through ACSS can follow a circuitous route. Once deposited, a cheque is sent to a regional data centre that serves the financial institution at which the cheque was deposited. The cheque is then delivered to a data centre that acts on behalf of the financial institution on which the cheque was drawn or written, which determines if the cheque will be honored or returned.

In most cases, cheques (including those which are certified and bank drafts) are then cleared overnight, not becoming final and irrevocable until the next day at the earliest.⁸ But those deposited very late in the day or through an Automatic Bank Machine (ABM) may not clear as quickly, while those deposited on the weekend do not clear until the next business day. Cheques drawn on an account in another region of the country take even longer to clear, as they may have to be sent by air or ground courier to a

regional data centre serving the financial institution on which then cheque was written, and then to the branch to determine if the cheque will be honored or returned.⁹

Electronic payments generally clear more quickly than cheques (usually the next business day). But when the payment first appears as a deposit in your trust account, it is not necessarily cleared. That is because not all electronic transfers are wires with LVTS protection.

In summary, regardless of whether the payment was by cheque or electronic transfer, ACSS payments – and that is the majority of payment transactions – are not cleared instantaneously, creating potential issues for lawyers who have a chain of closings to manage. Even though a credit has appeared in your bank account, if it was not received through an LVTS wire there is a possibility of reversal. That possibility is smaller if the original source of the funds was a certified cheque or bank draft (where a remote deposit was made) or if the transfer came from an account with additional assurances (such as contractual protection from a bank) standing behind it.¹⁰

Kathleen Waters is Vice-President, TitlePLUS.

What can lawyers do to gain assurance that they are dealing with cleared funds in their trust accounts?

1. To verify the form of funds deposited to your trust account, ask the purchaser's lawyer to fax a copy of the certified cheque or bank draft being deposited.
2. Ask your bank branch to contact the other branch and verify the form of the funds received. Verification that the deposit was in the form of a certified cheque or financial institution draft, for example, minimizes the risk that the funds will not clear.
3. In the case of remote deposits, ask your bank branch to manually intervene and have the funds posted to your

account immediately on receipt rather than have to wait for the deposit to appear overnight. Be aware that the bank is likely under no obligation to provide this service, even if you need to draw on these funds to close a purchase for your client.

4. Consider using the LVTS wire system, which gives "real value" assurance to the receiving lawyer. You may, however, need to work with your own and the purchaser's financial institution to ensure that the money will appear in your trust account quickly enough.

² In the Lang Michener Newsletter of Spring, 2003, Carl De Vuono and Melissa Li stated the following: "Since LVTS payments are final and irrevocable when they are made, the system offers certainty of settlement and real-time finality and irrevocability of payment". Furthermore, representatives of the Canadian Payments Association made the following statements in respect of LVTS on November 1, 2002: "(i) since the payment is an obligation of the sending institution, not the sending client, it does not matter if the sending client goes bankrupt, and (ii) with LVTS there are no possible overnight failure of financial institution issues (presumably because of the fact that the sending institution has to have sufficient value already posted to justify the dollar volume of transactions it is submitting)".

³ In the Lang Michener Newsletter of Spring, 2003, Carl De Vuono and Melissa Li stated, "All Canadian current dollar wire transfer payments are made through this system [i.e. LVTS]".

⁴ http://www.cdnpay.ca/systems/lvts_overview.asp.

⁵ http://www.cdnpay.ca/rules/lvts_rule_10.asp.

⁶ http://www.cba.org/CBA/EPIIgram/January_2003.

⁷ http://www.cdnpay.ca/systems/acss_overview.asp, and <http://www.cdnpay.ca/home/home.asp>.

⁸ http://www.cba.org/CBA/EPIIgram/January_2003.

⁹ http://www.cdnpay.ca/systems/acss_cheques.asp.

¹⁰ For instance, the Bank of Montreal – LawPRO Real Time Funds Transfer System, available from 2002 to 2004, had such assurances behind it for the receiving lawyer.