BIRMINGHAM LAW SOCIETY

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Looking to the Future: Accounts Rules review

SRA Consultation

June 2016

September 2016

Consultation: Looking to the future - SRA Accounts Rules Review

Consultation questionnaire form

This form is designed to be completed electronically—in MS Word. Please save it locally before and after completing it.

Question 1

Do you consider that the draft Accounts Rules (Annex 1.1) are clearer and simpler to understand and easier to comply with?

The Accounts Rules may be simpler but if the proposed changes do not protect client money then this subjective question becomes irrelevant. As can be noted from our responses to the questions below, we do not agree with the majority of the proposed changes. Client protection is the key issue here not simplicity.

In Weston v The Law Society (1998) Times, 15 July the Lord Chief Justice, Lord Bingham stated that: "The solicitors' accounts rules existed both to afford the public maximum protection against the improper and unauthorised use of their money and to assure them of that protection. Solicitors were accordingly under a heavy obligation, quite distinct from their duty to act honestly, to ensure observance of the rules."

The current high standards required by the Accounts Rules need to be maintained not watered down. All firms need to hold client monies in a consistent manner in accordance with prescriptive rules.

The SRA's argument that the rules need simplifying because not all qualified accountants' reports identifying minor breaches lead to disciplinary investigations does not bear close scrutiny. The very fact that for most firms handling large amounts of client money an annual accountant's report is required operates as a check and balance and as a method of maintaining standards. Also the SRA changed the rules last year so that accountants now have greater discretion in relation to minor breaches. The SRA needs to await the outcome of these changes before reaching any decisions.

It is acknowledged that there are in the Accounts Rules time limits that can cause problems for firms e.g. Rule 17.1 (c) and (e) and Rule 17.3 - transfer of monies earmarked for costs out of client account within 14 days and Rule 17.1 (b) (ii) payment of professional disbursements within 2 days or transfer to client account. An analysis of the advantages and disadvantages of these two time limits would be worthwhile but overall we do not consider that a wholesale transformation of the Accounts Rules is required. Overall the Accounts Rules work well and do not need to be dummed down in a quest for simplicity.

Question 2

Do you agree with our proposals for a change in the definition of client money? In particular do you have any comments on the draft definition of client money as set out in the draft Rule 2.1?

We vehemently disagree with the SRA's proposals for a change in the definition of client money. The effect of the change will be to transfer to the client the risk of losing their funds. We cannot identify any benefits in making such a change. The present arrangements work well and should be retained. The SRA's proposal offers no client protection and should be rejected.

Once a client's money is paid into office account, it is lost to the vagaries of the financial fortunes of the law firm concerned. The client has no control over those funds. The SRA seems to have conveniently forgotten the recession which began in 2007 and the severe impact of that recession upon the financial stability of law firms. If firms had been permitted to pay funds due for disbursements into office account at that time instead of client account the losses suffered by clients and therefore ultimately by the Compensation Fund would have increased tenfold if not more.

Many firms operate with overdrafts and as soon as client money is paid into office account it can only be drawn out again if the overdraft limit permits. Many firms have a daily battle with cash flow and funds due to clients would have to wait in the queue of outgoings until the overdraft is sufficiently reduced to permit payment.

If the salaries or the rent or the VAT need to be paid those payments will take priority over payments due for Counsel or medical experts. This proposal may cause Counsel and other experts to demand a contractual relationship direct with the clients. It will be an imprudent Counsel who will allow a law firm to pay in arrears for advice. Much more likely is that Counsel will require a payment in advance for work. Gone will be the days when Counsel will rely upon a firm's assurance that the fees have been received in advance and are sitting in client account. Also Counsel and medical experts will be much less likely to agree extended credit periods for contigency fee personal injury cases where they are reassured that when the claim is settled the payment for fees and disbursements will remain in client account and if the professional disbursement is not paid out within 48 hours it has to be transferred to client account. The present Rule 17 (b) and (c) provides reassurance that such professional disbursements will be protected and will not fall into the bottomless pit of office account.

If the SRA's proposal is adopted, it is not clear to whom the client monies that have been placed in office account belong. How does the firm hold the funds? Is it on trust for the client? Who is the beneficial owner of the funds? Do the funds still belong to the client until an invoice is agreed and then payment taken from the funds in office account? Or do the monies belong to the solicitor's firm? If the latter then the firm may be liable to pay VAT on the funds. The ramifications of this proposal have not been closely considered.

The redress/regulatory action set out in Annex 1.4 is technically correct but offers little protection to the client compared to the present arrangements. Placing the monies in client account is a protection in itself. Client account is regarded as

sacrosanct by clients and firms alike. The very fact that the regulated community is required under the current Rules to place monies in client account is sufficient protection in itself. The Administrative Court described client account and client funds as sacrosanct in Levy v SRA [2011] EWHC 740 (Admin). The Solicitors Disciplinary Tribunal also regards client funds and client account as sacrosanct.

The Accounts Rules exist to afford the public maximum protection - please see Weston v Law Society referred to under Question 1 above. The SRA must not interfere with the long established reputation of a solicitors client account as a place of safety for client funds. There is a long line of authorities which emphasise the importance to the profession as an outward sign of the trustworthiness of our profession and a unique selling point.

The SRA's headlong rush to modernise the profession ignores the commercial realities of running a practice and the likelihood that with the best will in the world payments for business expenses will take precedence over payments due for clients from office account especially when the firm is subject to a tightly imposed bank overdraft limit.

Question 3

Do you have any views on the use of credit cards to pay for legal services? If you are a firm, do you accept credit card payments? If not, why not? If you are a consumer, do you use a credit card to pay for legal services? If not, why not?

We have no firm views. Firms have been accepting payments for legal services for many years. We are not aware that this method of payment has ever caused any regulatory issues.

Question 4

Do you consider it appropriate that only client money (as defined in draft Rule 2.1) should be held in a client account?

We do not agree with this proposal. We repeat our earlier concerns as to the risks to clients if such a proposal were implemented.

The SRA asserts (paragraph 32) that Principle 4 - the duty to act in the best interests of the client - will be sufficient to protect clients if their payments intended for Counsel's fees and medical reports disappear into the black hole of office account. The SRA should be alert to the fact that most firms are struggling with cash flow issues. It is not a case of "Won't pay" but "Can't pay". Please see the SDT case of SRA v Nowell Mellor, Kirwan, Matthewman, Hackney & Hall SDT 11312-2014 where the firm had received payments for disbursements from the Legal Aid Agency which were paid into office account. The firm was then in such a bad financial position due in the main to problems caused by the late payment of legal aid fees that it could not release the monies from office account in order to pay off the disbursements.At one point the amount owed for disbursements was over £120,000.

Question 5

Do you agree with our proposal that mixed monies can be paid into client or business account as ling as the funds are then allocated promptly to the correct account ? In particular do you have any the new draft Rule 4.2 (see Annex 1.1)?

We do not agree with this proposal. The existing rule should be retained.

If mixed monies are paid into client account there is no risk. If mixed monies are paid into office account there is a risk of losing funds if the office account is overdrawn or the firm becomes insolvent. The risk is similar to the risk identified in the response to Questions 2 and 4 above. Office account is subject to commercial and financial pressures whereas client account is not and therefore always acts as a safe harbour.

Question 6

Having regard to our proposed definition of client money, do you agree that we can safely dispense with the specific Accounts Rules relating to payments from the Legal Aid Agency (LAA)?

We do not agree with the proposed change to the definition of client money so it follows that we do not agree with the proposal to remove the specific Accounts Rules relating the payments from the Legal Aid Agency. We favour retention of the existing Rules.

Question 7

Do you agree with our approach to allowing TPMAs as an alternative to holding money in a client account?

When TPMAs were first mooted by the SRA in 2015, the Birmingham Law Society ("BLS") conducted a non-scientific survey of its members and carried out inquiries with the Lyon Bar, with which it has a close association and which operates the CARPA system. The BLS responded at that time to the SRA's consultation and an extract from the BLS reponse is set out below (section marked in inverted commas).

"The protection of clients' monies is a paramount consideration. The overwhelming majority of firms hold a client account. For a few who never handle clients' monies the opportunity to operate an escrow account would provide no additional benefit or protection. From our inquiries even if the opportunity to have an escrow account were permitted none of the firms with whom we discussed the proposal (in excess of 20 including a representative selection of large national firms to sole practitioners) would elect to move to an escrow account.

The first reason for this is the profession's long established reputation for safeguarding clients' monies and on the rare occasion when something goes wrong the client is reimbursed for any loss either through the solicitors, their insurers or the Compensation Fund (as it stands) . This is the USP of the profession and is valued highly by both the public and the profession: solicitors are trustworthy. Escrow accounts provide no greater protection: indeed in the event of a bank failure it could be argued that they represent a greater risk. Bailing out banks is probably unlikely to happen in the future. Their existence could also undermine the public perception of solicitors: 'they are not to be trusted with our money.' The Bar is in an entirely different position never having historically handled clients' monies, seldom involved directly in transactions and, of course, the Bar is differently structured (all who practise through chambers or from home etc. are sole traders).

It is suggested that the proposal would provide a means of achieving a reduction in cost. The experience of the CARPA system is the exact opposite. It is extremely bureaucratic employing in Lyon very many more people than we suspect do even the largest magic circle firms in London and largest firms here in Birmingham in their accounts departments. Lyon services some 2,000 or so avocats whose activities, it should be borne in mind, are largely confined to the work of the courts/tribunals and, specifically, not property work. In Birmingham and the Black Country, there are over double this number of practitioners and this does not include the wider West Midlands, only a relatively small number of whom are involved directly in court work. The majority will be dealing daily with transactions involving property, estates and a broad spectrum of commercial work.

However, it is not the cost to the practitioner and, ultimately, the client of setting-up or running the bank that has to be taken into consideration. Most firms have arrangements with their banks which in one way or another offset their banking costs for the obvious reason that the banks want to attract clients' monies whilst on deposit with the solicitor. The SRA will know that at any one time these amount to some very large sums. The savings on what would be the normal commercial charges by a bank (which are much higher than for personal banking) are considerable. In a highly competitive market the result is that the client benefits. For the same reason, borrowing to develop the firm can be much easier, which could be an important access to justice consideration.

The Society is far from convinced that any saving in the costs of compliance with the Solicitors' Accounts Rules would make such a difference to a firm's overheads to influence its decision on whether to move to a third party bank account. It is so marginal as to make no difference.

The final, and perhaps uppermost in the mind of a client, would be the inefficiency of the third party banking system. We are advised that in Lyon it will take several days for the CARPA system to get the monies to the client and his/her avocat. It is by no means unusual for a compensation payment to be delayed by a fortnight notwithstanding the bank being in funds. Perhaps the final insult is that no interest is paid out to the client to cover the delay unlike here.

Assume for the purpose of this exercise that all of this is due to Gallic bureaucracy and inefficiency and ignore the experience of practitioners gained over many years of trying to live with a system which many would readily exchange for ours. Say the Anglo-Saxon model would eliminate all of these problems (we suggest this is a flight of fancy but.....). This does not solve the problem of transactional log jams developing where a multiplicity of payments in and out have to take place on the same day, sometimes simultaneously. The best and most common example of this would be the completion of a chain of property sales and purchases. A chain of 3 or 4 is not uncommon and longer chains are not unusual. The solicitors are centre stage, able to monitor the progress of the transaction at first hand, not one place removed. Were a bank operating an escrow account at any point in the chain, the whole series of subsequent transactions would be held-up, possibly for days while the appropriate consents/authorities are being obtained, scrutinised and approved or not as the case may be. Meanwhile clients are left at best frustrated, at worst without a roof over their heads.

It is instructive to note that a CARPA system is not operated by the French Notaires.

For these reasons the BLS does not see third party accounts as a panacea. We anticipate that even if they were available:-

- the take-up rate would be very small;
- in terms of protection for clients, the result would be neutral or possibly riskier;
- would be inefficient;
- would not reduce cost to the client but add to the cost of doing business."

We appreciate that since the above views were submitted to the SRA in 2015 some firms have been permitted to utilise TPMAs on the basis of waivers issued by the SRA. We have no idea of the numbers involved or whether the SRA has obtained feedback from these firms to ascertain whether these TPMAs are for the benefit of clients or whether as the BLS identified in 2015 the concerns regarding delay and cost are borne out. Until that evidence is obtained the BLS remains sceptical as to whether this change is necessary or beneficial to the regulated community or more importantly to the clients.

Question 8

If not, can you identify any specific risks or impacts of allowing TPMA that might inform our impact assessment?

Please see response to Question 7 above. Also it should be made clear that any TPMA arrangement needs to be in the name of the firm itself and that this system should not be used for setting up escrow type accounts in ther names of the clients themselves.

Question 9

Do you consider it appropriate for TPMAs to be used for transactional monies – particularly in relation to conveyancing? Or should the use of TPMA be restricted to certain areas of law? If so, why?

We pointed out in 2015 that delay would be a problem based upon the feedback from our colleagues in Lyon. Delay in conveyancing could be fatal to a chain of conveyancing transactions and cause inconvenience and cost for clients. More analysis needs to be undertaken before a change of this nature is implemented. Again the BLS is concerned that it would not be in the clients' best interests.

Question 10

Do you have any views on whether we need to retain the requirement to have a published interest policy?

We consider that the current rule should be retained. It provides transparency for clients and is in the public interest. An interest policy is an accounting issue and as such should be retained in the Accounts Rules not left to the more general duties under the Code of Conduct.

Question 11

Do you have any comments on the draft Accounts Rules, either as a whole or in relation to specific Accounts Rules?

Overall we consider that the revision of the Accounts Rules is based upon a misguided approach to the definition of client money. Please refer to the comments made above.

We have the following comments upon the draft Accounts Rules.

The definition of client money in Rule 2.1 is unclear. It is stated to be " relating to legal services delivered by you to a client ...." However we cannot trace a definition in the draft SRA Accounts Rules Glossary for "legal services". We can anticipate considerable differences of opinion between the profession and the SRA as to what constitutes "legal services". The SRA often has a narrow view of the work undertaken by solicitors and this can cause confusion and disagreement.

The definition needs to be clarified as it affects other Rules within the draft Rules - such as the definition of the use of client account as a "banking facility" in Rule 3.3

A better alternative may be that the definition should be linked to the definition of "regulated activities" which is contained in the draft Glossary. However, this definition does need checking against the definition contained in the Legal Services Act 2007. The wording set out in Annex 1.2 of the draft Glossary does not exactly replicate the LSA definition (section 12) and may need amending.

We would also refer to draft Rule 5.1 (c) which provides that client money can be withdrawn from client account "in the circumstances prescribed by the SRA from time to time" This appears to permit the SRA the right to change the rules to suit changing circumstances. Whilst one can see an advantage to this from the SRA's point of view, we are not convinced that it is in the best interests of clients or the profession. Accounts Rules need to be certain, clearly set out so they can be relied upon by all working in solicitors' accounts.

Also we are concerned by the continued imposition upon COFAs of personal liability for breaches of the Accounts Rules. This was not what was intended by the Legal Services Act 2007. The requirement under the LSA was for COFAs (and indeed COLPs) to "take all reasonable steps" to ensure compliance with the Accounts Rules. It is unfair to impose personal culpability upon COFAs for such breaches. The strict liability imposed by Rule 6 should be restricted to the firm and to the managers and not to the COFA who in many cases is not even a manager of the firm but an employee and therefore subject to the overall supervision of the managers.

Question 12

Are there other areas relating to the Accounts Rules that should be included in the toolkit for firms through guidance or case studies? If yes, pleas provide further details.

Nothing to add.

Question 13

Do you agree with our assessment of the consumer impacts in Annex 1.4? Do you have any information to inform our understanding of these risks further?

Nothing to add.

Question 14

Is there any information, data or evidence that you can provide or direct us towards that will assist us in finalising our impact assessment?

Nothing to add.

Thank you for completing the **Consultation questionnaire form**.

Please save a copy of the completed form.

Please return it, along with your completed **About you form**, as an email attachment to consultation@sra.org.uk, by **21 September 2016**.

Alternatively, print the completed form and submit it by post, along with a printed copy of your **About you form**, to

Solicitors Regulation Authority
Regulation and Education - SRA Accounts Rules 2017"
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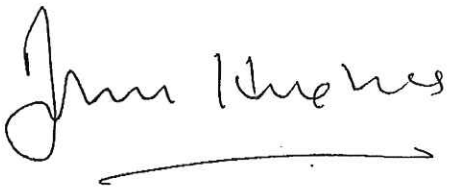

President

Birmingham Law Society

16 September 2016