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## **Response to SRA Consumer Protection Review**

### **Paper 1 - The model of solicitors holding client money**

**February 2025**

# **Response of the Professional Regulation Committee of the Birmingham Law Society to the SRA Consumer Protection Review**

## **Paper 1 – The model of solicitors holding client money**

This response has been prepared by the Professional Regulation Committee of the Birmingham Law Society. The Society is the largest local law society with some 9,000 members from all branches of the legal profession and practising in all aspects of law. The response represents the collective views of the Professional Regulation Committee whose members are specialist lawyers practising in all aspects of professional regulation and compliance for the legal profession. Contributions have also been made by the Birmingham Law Society Property & Development Committee and the Birmingham Law Society Council.

### **Introduction to Response**

Birmingham Law Society welcomes the opportunity to participate in this wide-ranging consultation with the SRA but it has huge concerns with the growth in the number and size of recent interventions resulting from misuse of clients' monies. For centuries, solicitors have been trusted to hold client money as an essential part of conducting their clients' business. In the rare event of a solicitor being found to have been dishonest the profession has always been rigorous in taking prompt action and importantly, ensuring that clients do not end up out of pocket. The result has been that trust and confidence in the profession has been maintained. This cannot be taken for granted and the actions or rather the inactions of the SRA have put this in jeopardy.

The causes of the recent increase in large scale firm failures warrants careful scrutiny. A rush towards what might be a superficially attractive solution such as doing away with the client account (which has stood the test of time) is thwart with risks, untold difficulties and would achieve little. We contend that by removing the client account from solicitors, this would simply transfer the issues to be addressed by third parties who are unlikely to have the same stringent

accounts rules that govern solicitors and their regulators whoever they might be. The proposal would be a disaster and would not result in any benefit to clients.

We submit that in making this suggestion the SRA is exceeding its remit. It represents a radical move away from the landscape in which solicitors have to operate. We reject any suggestion that there is pressure for change coming from clients. It must also be recognised that clients are not the only people to be considered. Other interested parties, including financial institutions, make extensive use of solicitors' client accounts in funding of transactions. In our opinion it would be essential to have a full wide-ranging consultation with everyone who might have an interest in or be affected by a change before any proposals could be tabled. There is no sign that there is a loss of trust or pressure for a change, which speaks for itself.

It is difficult not to draw the conclusion that the most significant if not the prime factors that have led to the present difficulties are the direct result of decisions taken by the SRA and systemic failures identified in the independent report of Carson McDowell. Two actions vital for the SRA to take which will go some way towards restoring stability are:

1. The reinstatement of the requirement to lodge an annual independent accountant's report is absolutely essential. The "light touch" is not effective. With rapid advancements in diagnostics technology and AI, this would no longer be unduly burdensome; and
2. Acknowledgment and a willingness to address all the issues identified in the report of Carson McDowell to the Legal Services Board.

If these steps were to be taken, they could be used as the first steps towards restoring a measure of confidence on the part of the profession in the SRA, which it is fair to say has never been lower. This could be an opportunity to move towards an improved working relationship. As it is, the profession is with justification frustrated by having to bear a 270% increase in contributions to the Compensation Fund resulting directly from the SRA's, as yet largely unacknowledged, mistakes.

## Response

***Q1. We want to ensure we fully understand the issues firms encounter in returning excess funds to clients or third parties – please outline:***

- ***the circumstances in which residual balances may arise on a particular matter***

These may arise where there is a retention in the matter, where an undertaking has been given which has not been discharged and in cases where a matter goes into abeyance, but the client is not wanting the monies or the file to be closed because the matter may resurrect in the future.

We feel that this proposal is a sledgehammer to crack a nut as one size does not fit all. The SRA are aware of the diverse size and types of firms it regulates.

Accountants can and do identify when residual balances need action.

- ***the steps that firms can take to make sure their client contact details remain up-to-date and any challenges with doing this***

Ensuring that up-to-date details are obtained at the conclusion of a matter and asking the client to advise the firm if their contact details do change.

- ***mechanisms that firms use to trace clients/third parties and any challenges with this.***

In most instances it would be through the last known contact details, phone number, address, email address and checking the electoral roll. The rules on confidentiality prevent us from contacting another party who may be able to assist if client consent was able to be obtained such as in the case of former joint clients where one of them has moved away from the address held.

There are good reasons why these cannot always be dealt with quickly or in some instances at all, for example, a client may not respond or may even not want the money.

***Q2. Do you agree that we should replace the term 'promptly' in rule 2.5 of the Accounts Rules and introduce more prescriptive requirements around returning funds to clients and third parties?***

Further clarity could be provided by the SRA however firms are constrained by the matter itself and how quickly this is able to be actioned internally. We do not consider that this is necessary for the reasons given above.

***Q3. Would a 12-week timeframe, from the conclusion of a case, provide sufficient time in which to identify an excess balance on a client account and return the funds to the client or third party where the firm holds their up-to-date contact details?***

In some cases, yes, however not all matters are standard and able to be dealt with within a prescribed period for the reasons given above. Matters involving section 38 and section 106 agreements for example. Again, this is unnecessary for the reasons set out above.

***If not, please give your reasons and include any specific examples of relevant issues.***

It would depend on the case itself and the internal resources available to the firm to deal with this, If, as is the case in most instances, more than one person or department is involved in organising the return of the funds and there was lack of staff available in the department or urgent matters which took priority over this work. Creating a prescribed regime would lead to more administration for the firm and SRA and more issues for both to deal with if timescales were not complied with.

***Q4. Should it not be possible to return excess funds to the client or third party within 12 weeks of the conclusion of a matter, is a further 12 weeks a reasonable timeframe to make all reasonable attempts to trace the relevant client/third party and where this is unsuccessful, donate the residual balance to charity or apply to us for approval to do so?***

In most instances this should be sufficient time to deal with this but in some cases this may depend on the internal resources of the firm, if the client responds or wants the money and how quickly the SRA responds to the application to donate the monies to charity.

***Q5. We would like to understand current practices around interest on the client account. Please tell us about your experience of the arrangements for interest on clients' money, including:***

- ***The extent to which client accounts generate interest, and – if so – how interest is apportioned between the firm and the client?***

Interest on general client account is not client money within the definition in rule 2.1. It must therefore be money that belongs to the firm. Rule 7 and legislation requires firms to pay clients a fair sum in lieu of interest. It is time consuming and disproportionate/expensive for firms to calculate the precise sums due and this is the reason for the current legislation and rules governing this area. General client accounts may generate interest. When and how interest is paid is set out in the firm's terms and conditions and payment of interest document.

- ***Any arrangements firms have to receive less or no interest on client accounts and what, if anything, the firm receives in return?***

Firms are required to have a policy on the payment of interest and to demonstrate that it is fair according to the rate of interest which an instant access bank account may pay.

- ***Whether and how firms make their clients aware (either directly or via terms and conditions) that their money could earn interest?***

This would be via the firm's terms and conditions and payment of interest policy.

- ***Whether clients are aware that firms may retain some of the interest earned on their money?***

The terms and conditions/policy would set out when interest is payable and when it is not.

***Q6. What are your views on the suggestion that we amend our rules to prevent firms retaining any of the interest earned on client money (subject to a de minimis)?***

Section 33 of the Solicitors Act 1974 deals with interest on client's money. What is set out in this section is not significantly different from the current Solicitors Accounts Rule 2019. The SRA saw no reason to change the rules regarding interest in 2019 when a major review of all the Rules was undertaken. The case in the headlines which has led to this proposed change/consultation involves a solicitor, and a few others, who was dishonest and such cases are fortunately rare therefore to remove the right of solicitors to hold client monies, as has been the case for hundreds of years is disproportionate to the risk.

***Q7. Are there circumstances where firms retaining some of the interest earned would be of benefit to the client?***

Yes if the amount is small and the client has moved out of the UK and no longer holds a bank account in the UK.

***Q8. What do you think would be the impacts of removing the ability for firms to earn interest on money held in client accounts? How could any short-term and/or long-term challenges be overcome?***

Primary legislation would be required to do this as the Solicitors Act would need changing.

Interest earned on client account may account for the costs of operating the account for the benefit of clients. If firms were to be prevented from retaining interest then they may seek to pass on the costs of operating a client account to clients.

***Q9. Are there any circumstances in which it is in the client's best interests to transfer client money from the client account to the office account before the work to which it relates has been completed? If so, please describe these circumstances.***

Only monies belonging to the firm can be transferred to office account therefore currently there are no circumstances where it would be in the best interests of the client to do this or even where it would be permissible. We think that the term "incurred" is unruly and the SRA should look at reverting back to the 1998 SARs. It is not clear what "incurred" means. The words "paid/not paid" are much clearer.

***Q10. Do you agree with our proposal to progress the amendment to rule 2.1(d) of the SRA Accounts Rules? Please explain your answer. No see the answer to question 3 and 6 above.***

No. The requirement for fees and disbursements to have already been incurred will place an unnecessary burden on firms that will affect the liquidity of those businesses.

## **Background**

The SRA's proposal in respect of proposed changes to rule 2.1(d) is inherently linked to proposed changes to rules 4.3 and 4.4, but that is not reflected in the question posed.

The proposal is to amend rule 2.1(d) as follows (amendments shown in red).

*"Client money is money held or received by you in respect of your fees and **any unpaid** disbursements if held or received prior to the delivery of a bill, **or other written notification, for the same once these have been incurred**".*

The proposed changes to rule 4.3 and the new rule 4.4 are:

"4.3 *Subject to rule 4.4, where you are holding client money and some or all of that money will be used to pay your costs:*

- a. *you must give the client or the paying party a written notification of the costs;*
- b. *this must be done before you transfer any client money from a client account to make the payment; and*
- c. *any such payment must be for no more than the specific sum identified in the bill or other written notification of the costs incurred and covered by the amount held for the particular client or third party".*

"4.4 *Rule 4.3 does not apply where you withdraw client money from a client account in full or partial reimbursement of money spent by you on behalf of the client or the third party for whom the money is held".*

The implication of rule 4.4 is that there is not a requirement to let the client know of the disbursement cost when a withdrawal is made from client bank account. This seems at odds with the spirit of the SRA rules to inform clients of withdrawals in advance of the funds being taken.

### **Fixed fees**

An increasing number of firms agree to undertake work on a fixed fee arrangement. This is beneficial to the client as it provides certainty as to the cost of the work.

Currently a firm can provide the client with a bill at the start of the matter and the fee can be paid directly into the firm's business bank account (office account) or into client account and then transferred to office account.

The proposed change includes provision for the fees to have been incurred. The proposed changes do not define what is meant by "incurred". In respect of disbursements this is understood to mean "paid", but it is not clear what is meant in the context of the firm's fees.

The implication is that there is a requirement for the work to have been done before the fee can be paid into office account. This is unnecessarily restrictive. In businesses other than legal services it is common for a client to need to pay upfront. There is no justifiable reason why legal services providers should be treated any differently. If a client wants to challenge the fee this can already be done using the process set out in s.70 Solicitors Act 1974.

### **Disbursements**

The proposed change will mean that funds in respect of a disbursement cannot be transferred until the cost of that disbursement has been incurred. Put another way, funds cannot be transferred from client account to the firm's office account for anticipated disbursements.

In conveyancing matters this is likely to lead to increased administration and costs. Most firms present a bill on exchange or completion and transfer funds for fee and disbursements at that point. However, if the requirement is for the disbursement to have been incurred this will not be possible for disbursements such as HM Land Registry fees.

This amended rule will also affect other areas of practice such as estate administration and dispute resolution.

The amended rule will require payment from office bank account before funds can be transferred from client to office bank account. The effect of this

to place an unnecessary burden on office bank account affecting law firm liquidity.

***Q11. Do you agree with our proposal to progress the amendments to rules 4.3, 4.3(a) and 4.3(c) of the SRA Accounts Rules, and the addition of rule 4.4? Please explain your answer.***

No. It is not appropriate for the solicitors' own monies/firm monies to be mingled with monies belonging to the clients. These amendments were proposed some time ago so it seems that the SRA are trying to bring these back again. We think some words have been missed out of the proposed wording to rule 4.3, namely, a bill. The current draft does not make sense.

***Q12. What are your views on the option to remove the ability for firms to enter into alternative arrangements about where client money will be held and how it will be used under rule 2.3(c)? Please explain your answer.***

Surely, this is contrary to the intention of the SRA to make the changes which they think necessary.

***Q13. What approaches do firms take when calculating the amount of money they request from clients in advance? In your response, please outline:***

- ***Any areas of practice where you consider that it is important to take advance fees***

Where the firm is paying out monies on behalf of the client for disbursements on property and litigation matters such as search fees and court fees.

- ***How a reasonable amount to request in advance can be calculated***

By virtue of the amount which is required to be paid out.

- ***Any alternatives to requesting advance fees***

In all areas of life, we are now increasingly required to pay in advance for goods and services. Traditionally solicitors would cover the disbursements themselves and then bill the client for everything at the end of the matter, but this relies on the client paying the solicitor in full which may not happen.

***Q14. When and how do you think we should, or should not, be more prescriptive about how much client money firms can request in advance of work being completed? In the areas where you think we should be more prescriptive, please outline what you think the implications would be for both clients and firms.***

This would be prohibitive and cumbersome as the SRA would need to have access to all the information relating to the different scales of transactions and matter that firms deal with to make this determination.

***Q15. What are your views of the long-term option of changing the model of firms holding client money? Please outline what you think the impact would be if firms were to hold no or substantially less client money?***

Firms hold client monies for a variety of valid reasons in accordance with the Solicitors Accounts Rule 2019 and the Solicitors Act 1974. Before even considering whether it would be possible to change what currently happens there have to be viable alternatives which currently do not exist.

***Q16. In your experience, are there areas of law or services in which it is essential for a firm to hold client money? What would happen if solicitors were not able to hold client money in these areas?***

Receiving monies for exchange of contracts and completion. Getting monies in on estates and distributing this to the beneficiaries. Section 38/106 agreements.

The process would become unnecessarily longer and more costly for the profession. The costs of this would ultimately be borne by the client which would make the English and Welsh legal profession less attractive to clients and businesses. The profession is respected world-wide and contributes a large amount of GDP into the UK economy.

***Q17. Do you have experience of any alternative method(s) of holding client money (such as a TPMA or other methods)? If you have experience of any alternative method, what has that experience been? What was the impact on clients and the firm?***

No. However, as there is only one provider this would be very restrictive and all it will do is create problems elsewhere removing the protection for clients altogether. This proposal, if implemented, would affect the way in which business is run in this country and send out a completely erroneous message that solicitors cannot be trusted. The profession has thrived for hundreds of years by holding client money. The problems caused relate to a few dishonest criminals. This is not reflective of the profession as a whole or a proportionate method of dealing with a few rogue solicitors.

Moving to the proposed system would also increase the money laundering risks to transactional work.

***Q18. If you have knowledge or experience of alternative approaches to holding client money, would you be open to further discussion with us as part of future development in this area? If yes, please confirm that you are happy for us to use the details you have provided to contact you, or please provide alternative contact details.***

No.

***Q19. In the context of this consultation, do you agree with our assessment of equality, diversity and inclusion considerations in our impact assessment? If not, what else do you think we should consider?***

Broadly speaking yes.

**Birmingham Law Society Professional Regulation Committee**

**February 2025**