



BIRMINGHAM LAW SOCIETY
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**Response to SRA Consumer Protection
Review**

**Paper 2 – Protecting the client money
that solicitors hold**

February 2025

Response of the Professional Regulation Committee of the Birmingham Law Society to the SRA Consumer Protection Review Paper 2 – Protecting the client money that solicitors hold

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 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. Do you think that we should be more prescriptive around the information that we must be notified of outside of our annual practicing certificate renewal exercise? If so, what information should we require and what risks should we target?

Authorisation is the point at which the SRA has the opportunity to understand how a new firm will be owned and managed, the services it will provide, whether it will hold client money, its insurance arrangements and how it will be financed. Further situations concerning changes to a firm also require the SRA to be notified or to approve a change. These include changes to ownership or management or the COLP/COFA roles. They also include changes to the entity and situations where a recognised body becomes an ABS.

When the SRA initially started authorising firms, it required huge amounts of information to be provided through the vehicle of a lengthy and complex application form. It quickly became clear that this scatter gun approach to collecting massive amounts of information about a new firm was inappropriate and unhelpful. Many applicants simply did not understand what they were being asked and why.

The form has since been significantly shortened and made much easier to understand. The question now is does the form collect too little information or information that is unhelpful? Does it provide an accurate picture of the firm's intended activities and, almost more importantly, the calibre of its managers and their ability to run a competent, compliant and financially successful business?

The latter is the most critical issue in terms of public interest/protection. The experience and integrity of its manager is key.

This leads on to the issue of the approval of individuals for specific roles, critically management and compliance roles. Whilst the FA1, firm application form, is probably asking the appropriate questions and some answers can be verified through various checks, more critical information is collected on the FA2 form which has to be completed by those looking to manage the firm and be responsible for its competence and compliance. This is fairly rigorous in testing knowledge and experience of the role but only captures information about compliance officers who need to be SRA approved. This has led in certain circumstances to non-lawyers, who wish to set up ABSs, looking to engage a solicitor for the COLP role, whether or not they have experience of the role, sometimes employing someone nearing retirement who no longer wants to take on fee earning work or who may be totally unsuitable.

Because all solicitors who meet the deeming requirements of rule 13.5 of the Authorisation Rules do not need SRA approval, this may be where the rules need tightening up so that solicitors who have never previously held a compliance role must be approved. In particular, where ABSs are largely owned by non-lawyers, and employ few solicitors, the compliance roles are of critical importance and those who take them on must be aware of the level of responsibility they are assuming. We have seen examples of dominant personalities holding sway over other partners and having too much control such as being sole or majority shareholder and COLP e.g. Axiom Ince. This is an aspect that the SRA needs to be alert to during the authorisation process.

More generally, all authorised firms that have features suggesting their model is in the higher risk bracket, such as swift expansion, multiple acquisitions, moving

rapidly into new areas of work, should be subject to more routine follow up contact with the SRA after changes have been recorded or approvals granted. This could be achieved through more direct contact with the COLPs and COFAs in such firms to ensure that they are abreast of compliance issues that may be affecting their business model. The COFAs, in particular, should be aware that they need to monitor, very actively, the firm's solvency and money in client accounts through thorough reconciliations.

The biggest risk to the SRA, clients and the profession is that of dishonesty and default with client money. Form filling can never predict this. The best independent scrutiny is an accountant's report. This shows where there is shortage on client account and can trigger an immediate inspection by the SRA. The risk has increased since the need for these reports to be filed was scrapped.

Q2. Do you think certain changes should require pre-approval by us and/or after-the-event monitoring and supervision? If so, which changes should this apply to and what risks should we target?

See response to question 1 above – in particular the suggestion that the deeming provisions for the approval of compliance officer roles may need tightening up. There should be more monitoring of obviously risky business models post authorisation, possibly through more contact with the COLPs/COFAs.

Q3. What impacts might arise from notifying us of changes in advance? Please provide specific examples of where firms provide information about changes to other third parties, e.g. insurers.

It is interesting that the SRA will not allow notification of a firm closure to be given until 7 days before actual closure. This is a process which takes considerable time and effort. It would probably help ensure more orderly closure

if closing firms had to give notification of their intention to close, say, 3 months before closure. They could then, at the very least, be prompted and directed to the SRA's guidance on the subject and be sent a copy of the relevant form. This might ensure, in some instances, a more orderly closure.

Q4. To what extent to you agree or disagree with our proposed approach to addressing dormant firms - taking action where a firm has not provided legal services and/or recorded zero turnover for 12 months, unless legitimate circumstances apply?

This seems a sensible approach to take. Fundamentally, it is misleading to the public because a dormant firm is being held out as active simply by being authorised and appearing on the register of firms. Dormant firms should always be asked if they are holding client money and how much. There could be residual balances which are preventing the firm from closing because, for example, a sole practitioner is ill or has lost capacity or cannot afford run off cover. The abandonment of a firm could also indicate more serious issues with client money.

Possibly the only authorised "law firms" which do not provide legal services are service companies which are used to pay staff.

Q5. Are there other circumstances not presented here where you think a law firm can legitimately record zero turnover for an extended period?

No.

Q6. Which of these three options for improving compliance with our requirements for accountants' reports and our ability to monitor this do you prefer and why?

The SRA's most important duty is to protect client money. Nothing else comes close. So, to have dispensed with a mandatory requirement to submit accountants' reports was short sighted to say the least. It seems absurd that when the biggest risk to the SRA, the profession and clients is client money going missing, the best indicator of problems, the accountants' report, is no longer required.

Rule 35 of the Accounts Rules 1998 required all firms holding client or controlled trust money to deliver an accountant's report. Section 34 of the Solicitors Act 1974 used to require the delivery of accountants reports but that provision was watered down in 2009 to say:

"The Society may make rules requiring solicitors to provide the Society with reports signed by an accountant (in this section referred to as an "accountant's report") at such times or in such circumstances as may be prescribed by the rules."

The two judgments below emphasise the heavy duty on firms to comply with the Accounts Rules.

In *SRA v Weston* CO/0225/98 [1998] The Times 15 July Lord Bingham said:

"...the tribunal had been at pains to make the point which was a good one that the solicitors accounts rules existed to afford the public maximum protection against the improper and unauthorised use of their money and that, because of the importance attached to affording that protection and assuring the public that such protection was afforded an onerous obligation was placed on solicitors to ensure that those rules were observed"

In *Levy v SRA* [2011] EWHC 740 (Admin) Cranston J said

“Client money is sacrosanct and a proper stewardship in relation to it is vital. Client money can only be used for that client’s matters, There must be proper systems and controls to ensure compliance with the accounts rules and it is for a firm’s principals to ensure that.”

We appreciate that accountants’ reports do not always guarantee that the accounting processes are 100% compliant nor can they always prevent determined fraudsters but the obligation to prepare for the annual accountant’s report focuses minds and focuses on improvements. It is the rigid discipline of being required to submit an accountant’s report which is the benefit here. An annual mandatory check can unearth financial stability problems as well as client account issues.

We are also aware that before the relaxation of the requirements in 2011 the SRA demanded strict compliance with deadlines for filing reports. Late filing of reports could result in the refusal to renew practising certificates. Late submission of an accountants’ reports was dealt with as a disciplinary matter as it demonstrated poor financial management and was often an indication of more serious underlying issues. The SRA has failed to foresee the unintended and obvious consequences of its so-called relaxation of these rules.

With today’s technology it should be possible for firms to lodge unqualified accountants reports with the SRA electronically to avoid administrative cost. It is only the qualified reports which will need to be scrutinised by an SRA employee but even some of this could be done electronically. The information contained in the unqualified reports will be available to the SRA for checking in cases of sudden changes in firm structures or SRA investigations into complaints

made to the SRA. The reports would also be useful for comparison purposes from year to the next – for example showing a decline in a firm’s fortunes or an inexplicable expansion.

We also understand from accounting colleagues that the current template accountants’ report is poorly drafted and does not require a signature or date upon it. It needs attention and improvement.

We would further recommend that there should be full disclosure in the template accountants report of the amount of client money held by the firm so that these figures correspond with the information provided by firms for the annual practising certificate renewal exercise. This information can then be cross checked if appropriate by the SRA.

In view of the above, the SRA should reintroduce the requirement for non-exempt firms to submit accountants’ reports. It is the only method of ensuring that firms are complying with their obligations. The evidence on page 17 of the consultation albeit of a limited sample reveals significant non-compliance for example of 244 Forensic inspections in 2023 25 (10%) of firms were in breach of the accountants reports requirements. The requirement should not have been removed in 2014. We cautioned against it at the time. It is an abrogation of the SRA’s duty to regulate in the public interest.

Q7. What are your views on whether we should consider requiring firms to periodically change their reporting accountant to safeguard independence, and if so, how often we should require this?

We have no firm views either way. We cannot see any evidence in the consultation paper to support or reject such a proposal.

Our more general observations are that the reporting accountant should hold appropriate professional qualifications, be experienced in dealing with solicitors' accounts and not have an own interest conflict i.e. no financial or personal interest in the firm.

Q8. Should we retain the existing exemption from obtaining an accountant's report, amend it, or remove it?

The existing exemption should be amended to provide that all firms holding client money should be required to obtain an accountant's report. This was always the requirement under the 1998 Accounts Rules and there was no reason to change it.

N.B. The change was introduced on 6 October 2011 with the SRA Accounts Rules 2011 and continued in the current SRA Accounts Rules 2019 with effect from 25 November 2019.

Q9. To what extent to do you agree or disagree that any manager that can unilaterally make decisions that impact client money handling should not also be able to hold a COLP or COFA role? Please explain your answer and include any suggestions for ensuring appropriate internal checks and balances.

The financial controls in a firm depend upon the size and type of firm and its attitude to risk. There are so many variations that it would be impossible for the SRA to regulate.

It is however best practice for non-sole practitioner firms to adopt safeguards in relation to the payment away of client monies that includes a second authoriser for the payment whether that be by a separate manager to the manager making

the payment request or if no additional manager approval is possible because there is no such manager in the firm, a senior employee.

Many law firms adopt such payment authorisation processes but not for all payments away from client account and only those payments that reach a certain level, for example £5,000. If the SRA were to insist on such two-tier authorisation it would be impossible for sole practitioner firms to implement for obvious reasons.

There is no evidence presented by the SRA to suggest that managers who are currently able to unilaterally pay monies away from client account should not be either the COLP or COFA. Nor in fact must the COLP or COFA be a manager in the law firm.

If the SRA decides that non-sole practitioner firms with one manager cannot have that one manager hold the role of COLP and/or COFA, this will likely cause the law firm to need to hire senior people in to their practices to take on these roles. This is highly unlikely to be affordable to most firms and will necessitate firms to consider whether it is financially viable to continue to operate.

Q10. Do you think this proposal should apply equally to all law firms, or should certain law firms – such as sole practitioners – be exempt if certain conditions are met? If so, what should these conditions be? Please explain the reasons for your answer.

Sole practitioners will be unable to adopt an authorisation process whereby another manager or senior employee co-approves payment away from client account. Sole practitioners often have no choice but to fulfil all regulatory roles such as MLRO, COLP and COFA (an MLCO will be unnecessary) as there are no

alternative people at their practice. Outsourcing (if that were possible) or seeking external help with such roles is ultimately not affordable for many sole practitioners and whilst there is a risk in one individual fulfilling all roles and being able to make unilateral decisions for paying away client monies, the sums will inherently be smaller and thus the risk smaller. The SRA present no evidence to the contrary.

Any imposition of conditions as suggested in question 9 should not apply to sole practitioners as it will not be workable and will ultimately lead to a decline in sole practitioners continuing in practice or not opening their doors to begin with.

Q11. To what extent do you consider our proposals to build and launch a package of support for compliance officers, and to strengthen our expectations for law firms to support their compliance officers, are sufficient? Are there issues we should target to enable compliance officers to meet their responsibilities effectively?

The SRA provides many resources already but there are improvements that can be made – starting with the SRA website. It needs to improve its search facility as a start. It is often easier to find a document by a Google search than a search on the SRA website. In addition, the SRA should maintain a well organised library of both current and historic rules and guidance. It is a sad reflection on the SRA's priorities that the earlier versions of its rules cannot be easily accessed. The importance of this measure is that not only most investigations cover earlier periods of regulation but also it enables COLP/COFAs to study and to learn from earlier regulation whilst dealing with current issues within their practice.

It would also be useful for all Case Studies that the SRA refers to in its published guidance and/or Warning Notices to include the citation of the SDT or

Administrative Court case that it is referring to. We appreciate that this would not always be possible for internal SRA decisions published on the SRA website as they are removed often a certain set period but this would not apply to SDT or Administrative Court judgments.

Also, the SRA should bear in mind that the role of the COLP or COFA may not be well understood by all those in law firms (particularly those who are not solicitors and provide business support). Any assistance the SRA can provide in making these roles known to all those in law firms is welcomed.

Many smaller firms would also benefit from “safe harbour” advice from the SRA helplines. Such firms cannot afford in-house compliance teams and often need input from the SRA that they can rely upon should there be an issue in the future.

Q12. 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?

No further comment

Birmingham Law Society Professional Regulation Committee

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