# Alternatives to handling client money

Briefing paper

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A briefing paper compiled by the legal services regulators of England and Wales:

- Bar Standards Board
- CILEx Regulation
- Costs Lawyer Standards Board
- Council for Licensed Conveyancers
- Institute of Chartered Accountants in England and Wales
- Intellectual Property Regulation Board
- Legal Services Board
- The Master of the Faculties
- Solicitors Regulation Authority

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# Executive summary

- This paper is a resource containing shared knowledge and thinking on alternatives to the handling of client money by legal practitioners – an activity which generates considerable consumer risk and a large quantity of regulation.
- It describes the features of alternatives to handling client money and describes models that are already in operation in legal services and elsewhere.
- It argues that alternatives to handling client money could bring significant benefits to consumers, practitioners and regulators – including reduction in regulatory burdens.
- The benefits and risks of such alternatives are discussed, along with possible safeguards.

# Context

1. This work was initiated at a post-Ministerial summit meeting of regulator chairs held in October 2014 which considered areas where the legal services regulators could collaborate to make further progress on deregulation.

2. The misuse of client money is one of the biggest regulatory risks in the legal sector, despite detailed regulatory arrangements designed to protect consumers. The vast majority of transactions are safely handled but there are a significant minority of occasions when client money is mishandled and this has persisted over recent years. In the solicitor profession in 2014, there were over 140 reports of misuse of client money or assets each month and 1,699 claims against the compensation fund totalling £24.69m in pay outs. Pay outs total in excess of £100m over the last five years.[1]

3. This document explores what options might exist for practitioners who prefer not to handle client money, and instead want to use alternative arrangements (for example escrow-style services provided by third party payment institutions[2] which are subject to appropriate consumer protection safeguards[3]) or indeed want to use a combination of client account and payment institution.[4] It looks at the benefits and possible risks of such arrangements. It does not propose a prohibition on legal practitioners handling client money. Rather the focus is on providing a greater degree of choice for providers that reduces risk and offers other benefits to consumers, providers and regulators.

4. In this context, this document is a shared resource exploring options that are designed to help the legal services regulators promote a number of the regulatory objectives:
   - Improving access to justice: possible cost savings from reducing risk in this area can be expected to be passed on to consumers in the form of cheaper legal services.
   - Protecting and promoting the interests of consumers: client money will be better protected from misuse by a rogue minority of legal practitioners ‘dipping into’ any accessible funds held in a client account. It would also be less vulnerable to issues created by poor financial management and inadequate security.

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[1] http://www.sra.org.uk/documents/SRA/performance/regulatory-outcomes-q4-2014.pdf. These figures include all claims on the Compensation Fund and are not solely client account issues.

[2] The term ‘payment institution’ is used in this document to describe a third party provider of payment services. Use of this term is not intended to imply that such service providers must conform with the definition found here http://fshandbook.info/FS/html/handbook/Glossary/P.

[3] A key feature of these systems is the dual authorisation process. Practitioners are unable to access the money without client approval. Once the client approval has taken place, the practitioner instructs the payment institution where to send the money. Annex A contains a list of relevant models in operation in legal services and elsewhere.

[4] For simplicity, discussion in this document is based on practitioners choosing either the traditional client account or a payment institution, although one possibility to consider is that they may wish to do both, depending on the client and the type of service required.

- Promoting competition in the provision of legal services: increased scope for legal providers to offer clients alternative models and differentiate from their rivals.
- Encouraging an independent, strong, diverse and effective legal profession: public perception of legal services may change as consumers are able to make a choice between providers based on their perceived risks.
- For clarity, it should be stated that barristers or costs lawyers are prohibited from handling client funds.

# Benefits of alternatives to handling client money

## For consumers

5. Enhanced security of client money is likely to be the principal benefit for consumers, provided appropriate safeguards are in place (see paragraphs 17–27) but there is also the scope for secondary benefits such as wider choice of payment arrangements and greater transparency of process. However, no system is failsafe; the use of alternative mechanisms for holding client money would reduce but not eliminate the scope for fraud.[5] For example, an escrow-type service, which requires authorisation from both the client and the firm for any payments or withdrawals to be made, should prevent 'dipping in' but not systematic fraud.

6. The Law Commission recently opened a consultation on protecting consumer prepayments in the retail sector following insolvency. Although its focus is on the retail sector, there could some useful lessons learned by the legal sector as and when alternative models for handling client money are considered.[6]

## For practitioners

7. There would be scope to reduce a considerable quantity of regulation on practitioners. Any firm choosing not to handle client money would no longer have to comply with any client account specific rules. Client account and client money regulation make up around 40 pages of the Solicitors Regulation Authority's (SRA) handbook. In the LSB's recent 'cost of regulation' research, providers placed client account rules in their 'top twenty regulatory areas to remove'.[7]

8. Practitioners would not need to be audited to the same degree. Any money held by practitioners would be their own (office money) and therefore an accountant's report would not be necessary as client money would not be held or received directly by the practitioner.

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5 In its June 2013 report *Financial Protection Arrangements* of June 2013, the Legal Services Consumer Panel named the main financial risks to consumers of legal services as**: theft of client money** – for example a mortgage is not paid off or client money is used as 'office money' to cover costs; **failure to account for client money** – such as a shortfall appearing in a client account due to poor accounting; **other dishonesty** – perhaps a dishonest instrument being drawn up or theft of property such as jewellery when administering an estate; and **insolvency** – if this happens the consumer may have problems getting in touch with the firm or accessing their papers and fees paid in advance may be lost.

6 http://lawcommission.justice.gov.uk/areas/consumer-prepayments.htm

7 Individuals rated client account rules ninth, and entities placed it eleventh in their 'top twenty areas regulatory areas to remove'. Practitioners also saw money laundering legislation as one of the most expensive regulatory burdens they faced. Even in the event that money laundering regulations were changed, practitioners would still need to be aware of their obligations to report any suspicions they might have about where the client's money is coming from. The introduction of a payment institution would not absolve the provider of relevant money laundering requirements.

9. Practitioners choosing not to handle client money could benefit from lower practising certificate fees (see paragraph 13 below) and lower compensation fund contributions (and possibly lower personal indemnity insurance (PII) premiums).[8] The third party service provider would provide the guarantees for any lost client money. In this context, it is interesting to note that:

   - The SRA reduces the practising fees of firms that do not handle client money. Such firms are exempt from paying the £548 (for year 2014/15) firm Compensation Fund contribution when renewing their practising certificate(s). For individuals, a flat fee of £32 is payable as a Compensation Fund contribution when applying for or on annual renewal of a practising certificate or registering as a registered European lawyer (REL) or a registered foreign lawyer (RFL) irrespective of whether they hold client money.[9]
   - CILEx Regulation recently consulted on changes to its compensation fund arrangements. One of the proposals was to set the amount regulated entities contribute to the compensation fund according to (amongst other things) the level of risk posed to client money. Where an entity holds client money they pay the full contribution, where client money is held in escrow the contribution is reduced and where the entity does not hold client money their contribution is reduced further to reflect the reduced risk of dishonesty posed.[10]
   - Under Carpa (the French solution for holding client money – see Annex A) the French legal services sector does not have a Compensation Fund because client money is not susceptible to theft by individual lawyers.

10. Another benefit for practitioners could be a reduced risk of being subject to harmful criminal activity. The third annual RBS/NatWest financial benchmarking report for law firms[11] found that the firms surveyed held over £1.5bn in client deposits.[12] It was noted that criminals ‘know’ legal firms carry large cash positions via client accounts, and that this represents a great opportunity for criminals to try and compromise a firm’s security arrangement in respect of their electronic payment governance.[13]

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[8] There is a risk of decreased contributions to compensation funds, particularly if there is widespread change to the ways in which client money is handled. Compensation funds are generally dealing with past problems (sometimes years old) so there is a risk of a mismatch between income and pay outs. Funds may have the ability to do a ‘special call’ for additional fee raising in these circumstances but that may be from a smaller pool so individual contributions would be higher. Regulators should consider this issue in taking any proposals in this area forward. It is also important to note that the practising certificate fee is also used to fund a number of things that would be unaffected by changes to regulation. Further, cost savings for practitioners do not necessarily directly relate to savings for consumers (see paragraph 14).

[9] It is worth noting that the Fund does not just cover circumstances where client money has been lost/taken. It also covers other issues such as interventions and cases where firms cannot meet civil liability to clients and had no insurance in place. Full details of the SRA fee policy can be found here: http://www.sra.org.uk/mysra/fees/fee-policy-2014-2015.page

[10] http://www.legalservicesboard.org.uk/projects/statutory_decision_making/pdf/20141222_Comp_Fund_contributions_submission.pdf

[11] http://www.nw-businesssense.com/financial-benchmarking-law.html

[12] 339 firms with revenues of less than £35m were surveyed. Almost 40% of them had fees of under £1.5m – with a combined income of £1.14bn and combined profits of £288m.

[13] http://www.legalfutures.co.uk/latest-news/sme-law-firms-strong-performance-creates-investment-pressure

11. There is also a potential benefit for sole practitioners and smaller firms. Those choosing not to handle client money may benefit from a reduced ‘perceived risk’ to the extent that it is easier for them to get onto the banks’ lenders panels.

12. The benefits for practitioners of not handling client money need to be weighed against the attractions for them of the current model, which include:

    - Cheaper bank charges/transaction fees as financial institutions link these benefits to number of transactions and the size of balances held.
    - Cheaper loans – for the same reasons as above.
    - Cultural issues – part of ‘what it means’ to be a lawyer.
    - Able to offer clients a one-stop shop service (which may also be attractive to consumers who may face less complex transactions and less administration, with no need for a separate relationship with the payment institution).
    - Transaction speed – not necessary to go through third party authorisation procedures.
    - Security from bad debt and protection against incurring abortive costs.
    - Able to manage affairs of a client who is incapacitated.
    - Interest (see Annex B).[14]

### For regulators

13. Regulators would no longer have to oversee client money rules in the same way for those practitioners choosing not to hold client money. However, regulators would still wish to operate with the confidence that both providers and consumers were protected to the same level as now (safeguards are discussed from paragraph 17 below). Client money regulation takes up a large amount of regulator resource. The use of different approaches to handling client money has the potential to drive the reduction or removal of regulation for those practitioners adopting such approaches. This in turn would enable regulators to reallocate resource and reduce the overall cost of regulation, if a material number of practitioners take up such alternatives. These savings could then translate into lower practising certificate fees for providers – with such reductions potentially targeted at those practitioners choosing not to handle client money (see paragraph 9 above) – and cheaper services for consumers.

[14] A figure of income from interest on client accounts for provincial firms of up to £50,000 per partner was quoted in the August 2014 Duff and Phelps report *Has the “perfect storm” become a hurricane for the legal service sector?*

# Possible risks of alternatives to handling client money

14. There are possible risks to both consumers and practitioners of an alternative arrangement to handling client money. These include:

    - **Payments process too slow** – a third party arrangement and the need for dual authorisation could slow down transactions that need to be arranged immediately. For example, speed can be crucial in conveyancing transactions.
    - **Added expense and burden of administration** – the inclusion of a profit making third party could increase overall costs (unless it resulted in improved efficiency overall) and practitioners and clients would need to have a relationship with the payment institution and fill out various forms. There is scope for mistakes which could lengthen a transaction, for example if an unengaged consumer were to authorise a payment without first verifying it with a practitioner.
    - **Fraud** – fraud might take a number of forms, for example: weak security controls by the payment institution could enable fraudsters to steal account details of a consumer or a practitioner and request the payment of funds. During a conversation with a payment institution, an individual voiced concerns over unregulated sections of this industry and how he suspected that ‘millions of pounds of client money is being held in schemes that is being used for money laundering, and/or criminal or terrorist funding’.
    - **Decreased overall influence or power of regulators and unclear financial stability of payment institution** – legal services regulators might not have the same power to require actions by or information from any third party provider. Equally, the financial stability of a third party service provider would not be as visible to the regulator as the financial stability of a regulated professional might be.
    - **Completion dates could be delayed** – banks at present see legal practitioners as a trusted partner. In the case where a last minute glitch threatens a house purchase going through, this network of existing relationships may make a practical solution easier to find than if a less familiar payment institution were involved. Further, if large numbers of practitioners used the same (or a limited number of different) payment institutions, a technical issue with a single payment institution’s computer system could cause widespread disruption across multiple property purchase chains (a ‘concentration’ risk).
    - **Different compensation schemes** – at present a client whose money has been mishandled is able to claim against a compensation scheme held by the relevant regulator. If a third party payment institution was to hold the funds then it is possible that any compensation scheme they have in place might not be as comprehensive as the relevant regulator’s (see paragraph 27).

15. In addition, any future regulatory arrangements would need to reflect the economic realities of the market. In preparing this document, we have spoken to a range of financial institutions and other parties to understand the possible implications. These factors include:

    - The use of a payment institution may make more commercial sense for some types of providers than others. The impact of one type of practitioner changing its preferred model on other parts of the market would need to be considered.
    - It has been suggested to us that banks may currently give favourable borrowing rates to law firms based in part on the amount of money those firms hold in a client account, on the basis that banks make other income from such firms in terms of telegraphic transfer fees for transfers in and out of the client account (for example for conveyancing transactions). Therefore, there could be a risk of 'loan re-pricing' for such firms if they opt to move away from handling client money.
    - Similarly, fraud risk and commercial reasons explain why banks might prefer client money (and transfer of mortgage funds) to continue flowing through legal practitioners' client accounts held at those banks, rather than those of a third party payment institution. As a result banks could be reluctant to deal with such providers.
    - The legal services market may be unattractive to payment institutions, for example if only a small number of firms wished to use their services and they were required to comply with additional regulatory requirements.

16. As approved regulators develop proposals in this area, it will be important for them to understand how their proposals might impact on the commercial realities of business across the diversity of providers. It bears repeating in this context that this paper focuses on alternatives for practitioners seeking to *opt out* of handling client money and does not argue for a prohibition on handling client money. If such alternatives were made available, law firms would need to weigh their options carefully and decide which route is in the best interests of their businesses.

# Safeguards

17. A reasonable starting position could be that the consumer protection features of any alternative model should be equivalent to that provided by the current regulation of client accounts, taking a risk based approach.[15] But it is also important that regulators do not 'choose winners' by designing their regulations around a specific alternative model for handling client money, or a specific service provider. Note this would not prevent regulators taking different approaches to determining whether particular payment institutions are acceptable, for example on a reactive case-by-case basis; by proactively pre-approving a number of schemes; or setting out principles/outcomes in the rules for practitioners and ensuring compliance via supervision and enforcement strategies.

### Existing legal services regulation

18. Some legal services regulators already allow alternatives to handling client money or are actively considering such mechanisms:
    - As barristers are prohibited from handling client money, the Bar Standards Board (BSB) already has 'live' rules and guidance in relation to alternative models for doing so – see Annex C. While the BSB has given itself the option of 'approving' individual third party providers, it has not done so yet.
    - As part of a major review of the rules relating to client accounts over the next two years, in April 2015 the SRA launched a consultation on an approach that would allow authorised entities to use third party managed account facilities (payment institutions), where these facilities have the necessary protections in place to ensure that clients' money is kept safe.[16]
    - As previously outlined, CILEx Regulation recently consulted on changes to its compensation fund arrangements such that where an entity holds client money in escrow, the entity's contribution to the compensation fund is reduced compared to where an entity holds client money directly (see paragraph 9).

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[15] This does of course assume that the existing protections are suitably evidenced and proportionate – it is beyond the scope of this paper to explore whether this is indeed the case.

[16] The full consultation paper and its annexes can be read and downloaded here: http://www.sra.org.uk/sra/consultations/regulatory-reform-programme.page. The SRA consulted on two approaches to the assessment of suitability of third party managed accounts: Option 1 – SRA approval of all specific third party managed accounts that may be used; and Option 2 – the SRA places appropriate criteria in rules, and has no role in approving specific schemes. The SRA also included at Annex A of its consultation a suggested (non-exhaustive) list of desirable features of third party managed accounts.

## Financial services regulation

19. Payment institutions are regulated under the Payment Services Regulations 2009, for which the Financial Conduct Authority (FCA) is the competent authority. This paper aims to set out an understanding of what FCA regulation a payment institution already attracts and therefore what protections consumers already benefit from, so that duplication of regulation or inconsistencies can be avoided. Equally, legal regulators need to be satisfied that existing arrangements designed for the financial services market adequately address the particular risks in the legal services market. The basic information below is designed to facilitate such analysis, but should be read alongside the FCA's formal documentation in this area.

20. The FCA set out its role under the Payment Services Regulations 2009 in a published Approach Document.[17] There are two types of payment institutions regulated by the FCA:

    - **Authorised payment institution (APIs)** – an authorisation and prudential regime for payment service providers that are not banks, building societies or e-money issuers (and so already authorised by the FCA). Because of their UK authorisation, authorised payment institutions have the right to establish or provide services across the European Economic Area (known as 'passporting' their services).
    - **Small payment institution (SPIs)** – allows businesses whose average turnover in payment transactions does not exceed €3m per month to be registered. Unlike APIs, SPIs are unable to passport. Further, a company operating and registered in the United Kingdom does not necessarily hold funds in the United Kingdom and could hold all deposited money in any country within the EEA.

21. Both types of payment institution are subject to conduct of business requirements, which relate to information required to be provided to payment services users, and specific rules on the respective rights and obligations of payment service users and providers. These rules relate to: charging; authorisation of payment transactions; execution of payment transactions; execution time and value date; and liability. All payment institutions are subject to FCA rules on handling complaints and consumers and micro-enterprises have access to the Financial Ombudsman Service.

22. However, the regulatory requirements for APIs are significantly different to those for SPIs in many respects, although SPIs may choose voluntarily to meet the same safeguarding requirements as set for APIs. APIs have to safeguard money either by segregating the funds and placing them in an account with an EEA authorised credit institution or in assets held by an authorised custodian, or arranging for the funds to be covered by an insurance policy or a comparable guarantee from a UK or EEA authorised insurer or credit institution. The FCA authorises APIs based on an assessment of governance arrangements, internal controls, risks management and money laundering controls. All individuals with responsibility for payment service activities have to demonstrate competence, capability, experience and good repute. In the event of insolvency, funds subject to a firm's safeguarding arrangements must be

[17] http://www.fca.org.uk/static/documents/payment-services-approach.pdf

returned to the customer. No other party, including other creditors, has any right to safeguarded funds.

23. Due to the lower risk nature of their activities, the registration process for SPIs is simpler and less costly, there are no ongoing capital requirements and SPIs are not obliged to safeguard money. However, registration may be refused if the individuals responsible for the management or operation of the business have been convicted of financial crimes and the directors and responsible persons must satisfy the FCA that they are of good repute and possess appropriate knowledge and experience.

24. The large majority of payment institutions are SPIs. Indeed, depending on how their business is structured, an escrow provider may not be captured under the payment services regime at all. Therefore, legal services regulators may wish to consider placing requirements on legal services providers only to engage with SPIs who agree to put in place additional measures to protect client money. These measures might be consistent with the generic features identified below or link explicitly to the safeguarding requirements that SPIs can voluntarily choose to comply with (see paragraph 26). SPIs wishing to serve the legal services market would have to comply with these measures.[18] In practice the legal regulator would make rules requiring entities only to deal with payment institutions meeting the additional measures. This would entail a balancing act for legal regulators: additional measures would enhance consumer protection but might deter payment institutions from serving the legal market. It might be that these extra requirements apply in some situations but not others, for example it might be disproportionate where small sums are involved (e.g. advance payment of fees for legal services) but necessary for larger sums (e.g. conveyancing or probate).

25. Separately, the Client Assets Sourcebook (CASS) in the FCA Handbook sets out the requirements with which firms must comply when holding or controlling client assets used for investment purposes.[19] These requirements are far stricter than those relating to payment institutions which are not subject to the CASS regime. It is very doubtful that it would be appropriate for lawyers to seek to make a financial return on client money through investment vehicles due to the risks involved, even if the proceeds were intended to be shared with clients. Legal regulators may wish to make specific provision for this in their rules.

[18] These extra measures would be a commercial decision for the SPI to take in order to serve the market.
[19] http://www.fca.org.uk/firms/markets/client-assets/client-assets-resolution-pack

## Desirable generic features of alternative models for the legal services market

26. Based on a consideration of the features of the legal services market, some generic elements of alternative mechanisms for handling client money that regulators should consider have been identified, though they may not apply in all cases, for example low risk solicitors. This is a non-exhaustive list based on an initial exploration of these issues. There is a close match between the features listed below and the regulatory framework for APIs operated by the FCA, which of course is designed to apply across a range of situations.
    - Appropriate registration with HM Revenue and Customs and regulation by the FCA.
    - The ownership and corporate structure of any payment institution would need to be clear to allow for any potential conflicts to be assessed, and for the arrangement for financial stability and business continuity to be understood.
    - An understanding of the provider's ability to take on the likely volume of transactions.
    - Funds held in the account are segregated, clearly identifiable, and referenced to the client and solicitor/entity. The third party provider should also keep accurate records of all transactions and provide these records as necessary to the other parties.
    - Clarity on fees to be charged and quality of service standards (e.g. transaction speed).
    - Arrangements for interest payments which are clear and are consistent with legal regulators' rules.
    - Clear information for consumers relating to each key stage of the 'trust' arrangement (i.e. the arrangements for correct release and receipt of funds between parties), rights and obligations, and routes to redress.
    - Clarity on boundaries of liability making it clear who should pay out in the event any client money is lost or the third party service provider enters insolvency.
    - An appropriate dispute resolution process and insurance arrangements if beneficial interest in money passes to the service provider.
    - Contact points for legal practitioners and consumers.
    - Arrangements for cooperating with regulators.
    - Arrangements for identity checks of senders and receivers of funds and compliance with anti-money laundering regulations.[20]
    - Consideration of whether consumers will have adequate information as may be necessary to understand differences in money handling arrangements and to weigh up from their point of view the benefits and drawbacks of the various options.

27. A key issue to consider is how money would be guaranteed and returned to a consumer if any money is lost. It should be noted that the Financial Services

[20] Both the firm and the payment institution would be subject to money laundering regulations and would have different, distinctive obligations. Therefore key respective duties would need to be agreed so as to avoid duplication.

Compensation Scheme (FSCS), which is overseen by the Prudential Regulation Authority, would probably not provide comprehensive cover in its present form as the maximum pay-out is £85,000 and many transactions are likely to exceed this. Further, FSCS protection does not apply if the payment institution itself fails. Also, consideration must be given as to how the 'look through' provisions might function for any particular payment institution.[21] The 'look through' provisions relate to whether the FSCS regards a particular account as a single account owned by the payment institution (in which case, only £85,000 compensation would be payable in total, regardless of how many different clients had money in that account), or whether FSCS 'looks through' the single account and recognises the multiple clients as separate individuals, each entitled to £85,000. Further, the FSCS £85,000 compensation limit applies to all accounts held by the consumer with the same financial institution, i.e. if the consumer banked with the same bank as the legal practitioner this would potentially expose consumers to unexpected losses due to the £85,000 total pay-out limit to any given consumer under FSCS, even where the 'look through' provisions applied.[22] By way of comparison, the maximum single grant that can be made from the SRA and CLC compensation funds are £2m and £1m respectively.

[21] The current arrangements can be found on the Financial Services Compensation Scheme's website. We generally cover client account arrangements (such as pooled accounts), which may be set up by solicitors, stockbrokers, landlords or other professionals, provided the deposit-taker (e.g. bank or building society) is authorised to accept deposits, which would normally be the case. The identities of the underlying clients and details of their respective entitlements to the deposit monies can be provided to the FSCS at the time a claim is made. The Law Society has its own compensation scheme for its members' investment business, which only applies in the case of dishonesty of a solicitor. In those circumstances claims against solicitors in England and Wales should be referred to it. Claims against solicitors in Scotland should be referred to The Law Society of Scotland. However, if the solicitor is holding your money in a client account with an authorised deposit-taker that fails, then your claim is against the deposit-taker and you should ask us to deal with it. The Law Society provides further guidance on this. Claims against some other professionals can be made to us, but only if the claim arises on or after 1 December 2001. If your claim is for activities before this date, look at our Claiming compensation booklet for details of the organisations to contact.

[22] The FSCS does not apply to SPIs.

# Annex A: Relevant models already in operation in legal services and elsewhere

### BARCO (Legal services industry).[23]

BARCO made the following points about its business:

- Established "to provide a solution for handling client money".
- A third party company, owned and operated by the Bar Council.
- Can be used for fees paid in advance, disbursements, settlements and money required in arbitration and mediation proceedings. In particular disbursements and settlements would be classified by the BSB as types of client money so the BARCO arrangements enables barristers to comply with the BSB's rules.
- Claimed benefits:
  - Reduce infrastructure costs.
  - Lower the cost of indemnity insurance.
  - Help keep the cost of risk-focused regulation as low as possible.
  - Protect your reputation and that of your profession if things go wrong.
- BARCO told us it does not need a compensation fund as they themselves are insured for all losses.
- Not a trust account – money paid to BARCO becomes BARCO's money, legally and beneficially.
  - The client retains a contractual right only to be repaid any residual balance.
- Regulated by the FCA, with expectations for the service provider set out by the BSB.
- BARCO will not intervene in disputes, but funds are frozen until it is resolved.
- Fees:
  - Up to £100,000 – 1%
  - £101,000–£500,000 – 0.75%
  - £501,000+ – 0.25%
- BARCO is currently in discussion with other professionals about adapting the model to widen its market into other legal areas (for example, as noted above the BARCO is seeking to address transaction speed issues so that it is suitable for conveyancing).
- BARCO also announced recently that it will hold the loans obtained for clients by Legal Cost Finance that will allow direct access barristers to offer payment plans to their clients.

[23] This information was taken from a presentation given by BARCO representatives at a stakeholder event held as part of the preparation for this paper.

### Transpact[24]

- Sees itself as a competitor to BARCO.
- Operates to protect parties during a transaction.
- Can be used for a number of transactions – online purchases, payment for work completed, integrated into an existing website flow.
- Money is transferred to beneficiary's accounts as soon as payment instructions are completed.
  - Received 'within minutes' if transaction is in GB pounds.
- Claimed benefits:
  - Payments protected by law.
  - Data held at security specialised sites.
  - Uses Faster Payments Service.[25]
  - Payments only released with confirmation – a small refundable sum paid from registered bank account.
- Client money is held in segregated client accounts of EU Government guaranteed banks – money is safe even if bank defaults.
  - Maximum pay out of £85,000 aggregated with one bank.
- Authorised and regulated by the FCA, and registered with HMRC.
- Has its own disputed process.[26]
  - A third party is nominated as 'referee' with its own 'nominated service'.[27]
  - Data held at security specialised sites.
  - If one party believes the money should be paid to them by Transpact, and the other side is not authorising payment then parties can call for arbitration.
  - Fee for this process is £20.00 plus any cost imposed by the referee.
- Fees:
  - £5.98 per transaction up to £10,000 (can be split between buyer and seller).
  - £10,000–£19,999 – £12 surcharge.
  - £20,000–£29,999 – £19 surcharge.
  - 18.15% charge on any interested earned while the transaction is live.

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[24] Information gathered from the Transpact website as part of desk research into alternatives to handling client money.

[25] The Faster Payment Service can only be used for transactions under £100,000. Any transaction above this should use CHAPS. This means that, at present, Transpact is unsuitable for most conveyancing transactions and any other high-value services.

[26] https://www.transpact.com/TranspactDisputeProcess.aspx

[27] http://www.refereeltd.com/

### Singaporean Conveyancing Money Rule Changes

- Previously, all conveyancing money was kept in a law firm's client account.
  - Client accounts governed by the Legal Profession Rules.
- July 2007 – a lawyer absconded with S$10m of client money.
  - Rules tightened further including cheques of more than S$5,000 had to be signed by two lawyers, and at least two signatories before a lawyer could hold or receive conveyancing money.
- But, November 2007 – a lawyer absconded with more than S$11m having withdrawn the money from the client account through cash cheques.
  - Chief Justice called for a 'workable scheme to protect clients' monies'.
- Key changes took effect 1 August 2011.
  - Lawyers are not allowed to receive and hold conveyancing money in normal client accounts – breaching this rule will result in a fine of up to S$50k and/or up to three year prison sentence.
  - Only allowed to hold conveyancing money in special Conveyancing Accounts opened with Appointed Banks. These accounts require two party authorisation for most transactions.
  - Buyers and sellers who do not wish to deposit money with their lawyers can instruct their lawyers to engage the Singapore Academy of Law (the promotion and development agency for Singapore's legal industry)) to hold conveyancing money.
  - Lawyers can receive and hold conveyancing money under escrow agreements between both buyers' and sellers' lawyers – more relevant for complex transactions.

### The Carpa – France

- The Carpa must receive all of the flows of funds handled by attorneys in connection with the professional activity.
  - It is not a bank or financial establishment.
- Each local Bar association (of which there are 181) has its own Carpa – although there are bodies and regulations that harmonise arrangement across the Carpas.
- Each attorney must be able to justify all sums that are deposited.
- Each 'professional law structure' has an individualised account within the relevant Carpa(s) and that account is divided into as many sub-accounts as there are cases. The sub-accounts are not permitted to be overdrawn or off-set against each other.
- Carpa ensures the coherency of the operation – both the origin of the funds and their destination.
- If attorney cannot justify who the money came from, who it is for and why it is for them the matter will be submitted to the 'ethical authority of the country which takes the case to investigate'.
- Carpa allows for checks against money laundering compliance.
- There is no compensation fund as money cannot be stolen by individual lawyers.

- Carpa deposits the money in a financial establishment.
- Carpa takes out sufficient insurance in order to guarantee against bankruptcy.
- System self-finances through the financial proceeds it generates.
- Carpa does not fund legal aid, but has been entrusted by the French Ministry of Justice with the management of State funds for legal aid.
- Some indications (in a speech by the President of the Bar Association of France dated 2003) of attempts to roll out the Carpa model to other European countries (Belgium, Italy) and to seek a European recommendation for the handling of funds by attorneys.

# Annex B: Other issues and defining client money

### Interest Payments

The basic principle of the SRA's rules on interest accrued during the time client money is held by the practitioner is that the practitioner cannot hide the amount of interest accrued and 'must account to the client or that person or trust for interest when it is fair and reasonable to do so'.[28] The Handbook also states that providers must have a written policy on the payment of interest which seeks to provide a fair outcome. This means it is at the discretion of the firm to come up with its own 'fair' policy on paying out interest. Providers do not have to pay interest on:

- Money held for the payment of a professional disbursement, once counsel etc. has requested a delay in settlement.
- On money held for the Legal Aid Agency.
- On an advance from you to fund a payment on behalf of the client or trust in excess of funds held for that client or trust.
- If there is an agreement to contract out the provisions of this rule under rule 25.

The interest policies of two law firms chosen at random are presented below.

*Firm 1*

Interest will be compounded quarterly, and will normally be paid once the client's matter has been concluded. Interest will not be paid if the sum calculated is less than £50 in total for the full period during which the client money is held, and the Firm will retain interest paid by the bank on the aggregate of all client money held in the general client account.

*Firm 2*

The rate of interest paid to clients on money held in the general client account is in line with the Firm's primary banker. Interest is normally calculated and applied on a quarterly basis at the end of June, September, December and March. Interest on money held in the general client account will not be applied to specific matters if less than £5 in any quarter and interest paid by the Firm's primary banker on the aggregate of all client money held in the general client account and, subject to any interest paid to clients as above is for the benefit of the Firm.

[28] http://www.sra.org.uk/solicitors/handbook/accountsrules/part5/content.page

## Defining Client Money

While there are some similarities across a number of bodies from both the legal and other sectors, there is not a single accepted definition of client money. We have created a 'working definition' of client money using examples from bodies from both legal services and other areas.

"Client money means money of any currency and in any form held or received by a firm as Bailee, agent, trustee or stakeholder that is beneficially owned by or for the benefit of a client or indented by another party to be transmitted to a client".

All definitions considered for this can be found in full below.

### BSB

(a) Money, securities or other assets beneficially owned by a client; or

(b) Money, securities or other assets provided by, or for the benefit of, your client or intended by another party to be transmitted to your client,

But excludes:

(c) A fixed fee paid in advance; or

(d) A payment made in settlement of an accrued debt; or

(e) Money which belongs to your employer

*Source: BSB website*

### CLC

Client money is any money held or received for a client by a CLC regulated person or body incidental to the provision of legal services regulated by the CLC.

*Source: Provided by the CLC via email*

### CLSB

Any client monies received that are not in payment of invoiced professional fees for costs law services or disbursements.

*Source: Provided by the CLSB via email*

## ICAEW

Clients' Money means money of any currency (whether in the form of cash, cheque, draft or electronic transfer) which a firm holds or receives for or from a client, including money held by a Firm as stakeholder, and which is not immediately due and payable on demand to the Firm for its own account. Clients' Money must be held in the currency in which it was received unless the client instructs otherwise in writing.

*Source: ICAEW website*

## Master of the Faculties

"Client's Money" shall mean money held or received by a notary on account of a person for whom he is acting in relation to the holding or receipt of such money either as a notary or, in connection with his practice as a notary, as agent, Bailee, stakeholder or in any other capacity.

*Source: MOF website*

## SRA

"Client money" – money held or received for a client or as trustee, and all other money which is not office money.

"Client money" includes money held or received:

(a) As trustee;

(b) as agent, Bailee, stakeholder, or as the donee of a power of attorney, or as a liquidator, trustee in bankruptcy, Court of Protection deputy or trustee of an occupational pension scheme;

(c) For payment of unpaid professional disbursements;

(d) for payment of stamp duty land tax, Land Registry registration fees, telegraphic transfer fees and court fees (but see also guidance note (a));

(e) As a payment on account of costs generally;

(f) as a financial benefit paid in respect of a client, unless the client has given you prior authority to retain it (see Chapter 1, outcome 1.15 and indicative behaviour 1.20 of the SRA Code of Conduct);

(g) Jointly with another person outside the firm.

Money held to the sender's order is client money.

(a) If money is accepted on such terms, it must be held in a client account.

(b) However, a cheque or draft sent to you on terms that the cheque or draft (as opposed to the money) is held to the sender's order must not be presented for payment without the sender's consent.

(c) The recipient is always subject to a professional obligation to return the money, or the cheque or draft, to the sender on demand.

*Source: SRA website*

**FCA Handbook Glossary**

(1) [Deleted]

(2) (in CASS 5) subject to the client money rules, money of any currency which, in the course of carrying on insurance mediation activity, a firm holds on behalf of a client or which a firm treats as client money in accordance with the client money rules.

(2A) (in FEES, CASS 6,CASS 7, CASS 7A and CASS 10 and, in so far as it relates to matters covered by CASS 6, CASS 7, COBS or, GENPRU and IPRU(INV) 11) subject to the client money rules, money of any currency:

- (a) That a firm receives or holds for, or on behalf of, a client in the course of, or in connection with, its MiFID business; or
- (b) That, in the course of carrying on designated investment business that is not MiFID business, a firm holds for a client; or
- (ba) that a firm receives or holds for, or on behalf of, a client in the course of, or in connection with, its stocks and shares ISA business; or
- (c) That a firm treats as client money in accordance with the client money rules.

(2B) (in CASS 11 and CONC 10) money which a CASS debt management firm receives or holds on behalf of a client in the course of or in connection with debt management activity.

(3) (In MIPRU):

- (a) in relation to an insurance intermediary when acting as such, money which is client money in (2);
- (b) In relation to a home finance intermediary when acting as such, money of any currency which in the course of carrying on home finance mediation activity, the firm holds on behalf of a client, either in a bank account or in the form of cash.

(4) (In COMP) client money for the purposes of the relevant client money rules.

*Source: FCA Handbook*

# Annex C: BSB client money rules and guidance from BSB Handbook

### Rules on client money

rC73 – Except where you are acting in your capacity as a manager of an authorised (non-BSB) body, you must not receive, control or handle client money apart from what the client pays you for your services.

rC74 – If you make use of a third party payment service for making payments to or from or on behalf of your client you must:

1 – Ensure that the service you use will not result in your receiving, controlling or handling client money; and

2 – Only use the service for payments to or from or on behalf of your client that are made in respect of legal services, such as fees, disbursements or settlement monies; and

3 – Take reasonable steps to check that making use of the service is consistent with your duty to act competently and in your client's best interests.

rC75 – The Bar Standards Board may give notice under this rule that (effective from the date of that notice) you may only use third party payment services approved by the Bar Standards Board or which satisfy criteria set by the Bar Standards Board

*Guidance on Rules C73 and C74*

gC103 – The prohibition in Rule C73 applies to you and to anyone acting on your behalf, including any "ProcureCo" being a company established as a vehicle to enable the provision of legal services but does not in itself supply or provide those legal services. Rule C73 prohibits you from holding client money or other client assets yourself, or through any agent, third party or nominee.

gC104 – Receiving, controlling or handling client money includes entering into any arrangement which gives you de facto control over the use and/or destination of funds provided by or for the benefit of your client or intended by another party to be transmitted to your client, whether or not those funds are beneficially owned by your client and whether or not held in an account of yours.

gC105 – The circumstances in which you will have de facto control within the meaning of Rule C73 include when you can cause money to be transferred from a balance standing to the credit of your client without that client's consent to such a withdrawal. For large withdrawals, explicit consent should usually be required. However, the client's consent may be deemed to be given if:

1 – the client has given informed consent to an arrangement which enables withdrawals to be made after the client has received an invoice; and

2 – the client has not objected to the withdrawal within a pre-agreed reasonable period (which should not normally be less than one week from receipt of the invoice).

gC106 – A fixed fee paid in advance is not client money for the purposes of Rule C73.

gC107 – If you agree with a client , who can reasonably be expected to understand the implications of such an agreement, that (1) your fee for any work will be charged according to the time spent on it, but (2) you will be paid a fixed fee in advance for it, and (3), when the work has been done, you will pay the client any difference between that fixed fee and the fee which has actually been earned, and (4) you will not hold the difference between the fixed fee and the fee which has been earned on trust for the client , that difference will not be client money. Such fees may be considered as client money if you cannot demonstrate that the agreement was made in advance and on clear terms. You should also consider carefully whether such an arrangement is in the client's interest and that the client fully understands the implications.

gC108 – Acting in the following ways may demonstrate compliance with Rules C73, C74 and C75:

gC109 – Checking that any third party payment service you may use is not structured in such a way that the service provider is holding, as your agent, money to which the client is beneficially entitled. If this is so you will be in breach of Rule C73.

gC110 – Considering whether your client will be safe in using the third party payment service as a means of transmitting or receiving funds. The steps you should take in order to satisfy yourself will depend on what would be expected in all the circumstances of a reasonably competent legal adviser acting in their client's best interests. However, you are unlikely to demonstrate that you have acted competently and in your client's best interests if you have not:

1 – ensured that the payment service is authorised or regulated as a payment service by the Financial Conduct Authority (FCA) and taken reasonable steps to satisfy yourself that it is in good standing with the FCA;

2 – if the payment service is classified as a small payment institution, ensured that it has arrangements to safeguard clients' funds or adequate insurance arrangements;

3 – ensured that the payment service segregates client money from its own funds;

4 – satisfied yourself that the terms of the service are such as to ensure that any money paid in by or on behalf of the client can only be paid out with the client's consent;

5 – informed your client that moneys held by the payment service provider are not covered by the Financial Services Compensation Scheme.

gC111 – Unless you are reasonably satisfied that it is safe for your client to use the third party payment service (see rC74.3, gC109 and gC110 above), advising your client against using the third party payment service and not making use of it yourself.

gC112 – The Bar Standards Board has not yet given notice under rule C75.