



The Law Society

# **Discussion paper: options for the SRA Accounts Rules**

January 2016



## Introduction

In anticipation of the SRA reviewing its Accounts Rules in Spring 2016, the Law Society has examined the existing requirements in detail and devised options for how the rules could be improved. The Society is keen to understand the views of members on both the options in this paper and the Accounts Rules in general. The views of practitioners will inform the Society's policy position when the SRA consults in 2016.

The Society is not proposing a preferred or recommended option and if practitioners have views that are not covered in this paper, we would very much welcome them.

The Law Society asks solicitors to consider the following options:

**Option A.** Retain the current Accounts Rules.

**Option B.** Replace the existing rules with an approach based on the Overseas Accounts Rules.

**Option C.** Simplify and shorten the existing Accounts Rules.

**Option D.** Simplify and shorten the Accounts Rules (as in option C) and remove the requirement for a separate client account.

**Option E.** Adopt a *de minimis* approach: Disapplying certain rules to firms which only use client accounts sparingly (e.g. if the amount in the client account at any one time does not exceed a certain threshold and/or a total level during the financial year).

**Option F.** Additional option - the removal of rule 1.2, which places duties on COFAs

The SRA Handbook's Reporting Accountant Requirements have not been included in the options for this paper as these are under review.

## Summary of questions:

**Question 1.** Which out of options A - F would you favour and why?

**Question 2.** Which out of options A - F would you least favour and why?

**Question 3.** Do you have any other comments or proposals on changes to the Accounts Rules?

## How to respond

You can respond to this discussion paper by post or email. The deadline for responses is 29 April 2016.

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## **Option A - retain the current Accounts Rules**

The current Accounts Rules can be found in the SRA Handbook<sup>1</sup>. The rules are extensive and complex and some practitioners may wish for these to be simplified. However, others may not be inclined towards change as they already understand how to comply with the related requirements and therefore view change as detrimental.

## **Option B - Replace the existing rules with an approach based on the Overseas Accounts Rules.**

Since November 2015, the Overseas Accounts Rules have been located in Part 4 of the SRA Overseas Rules. Practitioners are expected to comply with Overseas Principle 10, "*You must protect client money and assets*", as well as an amended version of the current Overseas Accounts Rules.

Option B would be similar to the principles based approach to the Overseas Accounts Rules<sup>2</sup>. It would also be a similar approach to that adopted by the American Bar Association<sup>3</sup>.

In addition to the draft text below, a principle similar to overseas principle 10 which states, '*you must protect client money and assets*', would be adopted. It would also be necessary to adapt and include rules relating to the payment of interest and accountants reports.

Potential draw-backs associated with the adoption of this approach would include the risk of unintended consequences. There are fewer overseas solicitors than there are solicitors in England and Wales and less prescriptive rules applied to a larger population could lead to the emergence of unforeseen issues. It would be difficult to impact assess these changes. A principles based approach would be likely to allow more flexibility and freedom for firms in how they interpret the rules; however, it would also create difficulties for practitioners who would prefer clear instructions to flexibility.

### Option B draft rules

#### *"Dealing with client money*

*In all dealings with client money, you must ensure that:*

- a. it is kept in a client account, separate from money which is not client money;*
- b. on receipt, it is paid without delay into a client account and kept there, unless the client has expressly or by implication agreed that the*

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<sup>1</sup> <http://www.sra.org.uk/solicitors/handbook/accountsrules/content.page>

<sup>2</sup> Note: the proposed drafting for Option B is based on text included in version 14 of the SRA Handbook. Version 15 was launched on 1 November 2015.

<sup>3</sup>

[http://www.americanbar.org/content/dam/aba/migrated/cpr/clientpro/adopted\\_8\\_10\\_10.authchec kdam.pdf](http://www.americanbar.org/content/dam/aba/migrated/cpr/clientpro/adopted_8_10_10.authchec kdam.pdf)

*money shall be dealt with otherwise or you pay it straight over to a third party in the execution of a trust under which it is held;*

- c. it is not paid or withdrawn from a client account except:
  - i. on the specific authority of the client;*
  - ii. where the payment or withdrawal is properly required:
    - A. for a payment to or on behalf of the client;*
    - B. for or towards payment of a debt due to the firm from the client or in reimbursement of money expended by the firm on behalf of the client; or*
    - C. for or towards payment of costs due to the firm from the client, provided that a bill of costs or other written intimation of the amount of the costs incurred has been delivered to the client and it has thereby (or otherwise in writing) been made clear to the client that the money held will be applied in payment of the costs due; or**
  - iii. in proper execution of a trust under which it is held;**
- d. accounts are kept at all times, whether by written, electronic, mechanical or other means, to:
  - i. record all dealings with client money in any client account;*
  - ii. show all client money received, held or paid, distinct from any other money, and separately in respect of each client or trust; and*
  - iii. ensure that the firm is able at all times to account, without delay, to each and every client or trust for all money received, held or paid on behalf of that client or trust; and**
- e. all accounts, books, ledgers and records kept in relation to the firm's client account(s) are preserved for at least six years from the date of the last entry therein."*

### **Option C** - Simplify and shorten the existing Accounts Rules.

This approach would significantly simplify and reduce the size of the Accounts Rules, removing information that is duplicated or is unnecessary. It would be in line with the Government's policy to reduce unnecessary regulation and may allow more flexibility for firms. It would also be compatible with the drive towards principle-based and less prescriptive regulation. As with option B, there is a risk of unintended negative consequences and there would be less clarity for practitioners in relation to what is practically required in order to ensure compliance.

[A section on accountant's reports has been deferred in view of the SRA's recent review of the rules relating to reporting accountants' requirements. Rule 19 of the current Handbook which refers to treatment of payments to legal aid practitioners has been moved to the end of this option. As there is a separate section for legal aid, so a separate brief section is intended in relation to special circumstances such as liquidators etc as in the current rule 8.]

#### Option C draft rules

##### *"Accounts Rules for England and Wales*

1. *These rules apply to authorised persons regulated in England and Wales. MDPs are required to adhere to these rules in respect to regulated activities only.*
2. *You must:*
  - a. *keep client money in a client account unless you have sufficient reason to do otherwise and permission from the client confirmed in writing;*
  - b. *use each client's money for that client's matters only; keeping such money separate from money belonging to you or your firm in a client account(s);*
  - c. *use money held as trustee of a trust for the purposes of that trust only;*
  - d. *establish and maintain proper accounting systems and records, and proper internal controls over those systems;*
  - e. *pay interest when reasonable and in accordance with the policy set by the firm;*
  - f. *obtain and deliver annual accountant's reports as required by the rules.*
3. *All of the principals in a firm must ensure compliance with the rules by the principals themselves and by everyone employed in the firm. This duty also extends to the directors of a recognised body or licensed body which is a company, or to the members of a recognised body or licensed body which is an LLP. It also extends to the COFA of a firm*

4. *Any breach of the rules must be remedied promptly upon discovery by the principals of the firm. This includes the replacement of any money improperly withheld or withdrawn from a client account.*
5. *If, when acting in a client's matter, you hold or receive money jointly with the client, another practice or another third party, proper records must be maintained.*
6. *In circumstances where you are jointly holding funds with another practice, both parties must keep proper records.*
7. *If you operate a client's own account, you must keep proper records as if it was client money.*

8. *Client account(s):*

- a. *of regulated entities must be in the name recognised by the SRA or, if incorporated, the name registered at Companies House.*
- b. *of trustees may be in the name of the trustees;*

*The name of the account must also include the word "client" (an abbreviation is acceptable and "clt" would be the most suitable abbreviation to use).*

9. *A client bank account must be in England and Wales.*
10. *Money held in a client account must be immediately available, even at the sacrifice of interest, unless the client otherwise instructs, or the circumstances clearly indicate otherwise.*
11. *Client money should not be kept other than in a client account without sufficient reason to do so and permission from the client.*
12. *A client (or other person who is entitled to money held on client account) should:*
  - a. *have their money returned as soon as there is no longer any proper reason to retain funds*
  - b. *be promptly informed in writing of the amount of client money retained at the end of a matter and the reason for the retention*
  - c. *be informed in writing at least every twelve months thereafter of the amount of client money held and the reason for the retention.*
13. *Payments into and withdrawals from a client account must relate to instructions on an underlying legal transaction which is (a) carried out by the practice and (b) of a type normally carried out by regulated persons.*
14. *Where the proper recipient of client money cannot be traced a withdrawal of client money may be made only where the amount held does not exceed £500 in relation to any one individual client or trust matter and you:*

- a. *establish the identity of the owner of the money, or make reasonable attempts to do so;*
  - b. *make adequate attempts to ascertain the proper destination of the money, and to return it to the rightful owner, unless the reasonable costs of doing so are likely to be excessive in relation to the amount held;*
  - c. *pay the funds to a charity. The practice should ensure that it has a deed of indemnity from the preferred charity so that funds may be refunded to the practice if called for;*
  - d. *record the steps taken in accordance with rule 15(a)-(c) above and retain those records, together with all relevant documentation (including receipts from the charity), and*
  - e. *keep a central register.*
15. *Any funds where the correct categorisation is unclear should be paid into client account(s) and then transferred from the client account to the office account if appropriate.*
16. *If you properly require payment of your fees from money held for a client or trust in a client account, you must first give or send a bill of costs, or other written notification of the costs incurred, to the client or the paying party.*
17. *If money is paid to you by a client for a specified purpose, and not for your benefit, it must be paid into a client account and used for that purpose.*
18. *Money withdrawn in relation to a particular client or trust from a general client account must not exceed the money held on behalf of that client or trust in all your general client accounts (except as provided in rules 19 and 20 below).*
19. *You may make a payment in respect of a particular client or trust out of a general client account, even if no money (or insufficient money) is held for that client or trust in your general client account(s), provided:*
- a. *sufficient money is held for that client or trust in a separate designated client account; and*
  - b. *the appropriate transfer from the separate designated client account to a general client account is made immediately.*
20. *A client account must not be overdrawn, except in the following circumstances:*
- a. *A separate designated client account operated in your capacity as trustee can be overdrawn if you make payments on behalf of the trust (for example, inheritance tax) before realising sufficient assets to cover the payments.*

- b. If a sole practitioner dies and his or her client accounts are frozen, overdrawn client accounts can be operated in accordance with the rules to the extent of the money held in the frozen accounts.*

*Legal entities should have systems in place where only approved responsible persons are able to withdraw from the client accounts(s).*

- 21. You must have a written policy on the payment of interest, which seeks to provide a fair outcome. The terms of the policy must be drawn to the attention of the client at the outset of a retainer, unless it is inappropriate to do so in the circumstances. Interest must be calculated to cover the whole period for which the money is held.*
- 22. Regular payments from the Legal Aid Agency must be paid into an office account in England and Wales.*
- 23. You must within 28 days of submitting a report to the Legal Aid Agency, notifying completion of a matter, either:*
  - a. pay any unpaid professional disbursement(s), or*
  - b. transfer to a client account a sum equivalent to the amount of any unpaid professional disbursement(s),*

*unless the Legal Aid Agency permits you to submit reports at various stages during a matter; in which case, the requirement above applies to any unpaid professional disbursement(s) included in each report so submitted.*

- 24. If the Legal Aid Agency has paid any costs to you or a previously nominated firm in a matter (advice and assistance or legal help costs, advance payments or interim costs), or has paid professional disbursements direct, and costs are subsequently settled by a third party:*
  - a. The entire third party payment must be paid into a client account.*
  - b. A sum representing the payments made by the Legal Aid Agency must be retained in the client account.*
  - c. Any balance belonging to you must be transferred to an office account within 14 days of your sending a report to the Legal Aid Agency containing details of the third party payment.*
  - d. The sum retained in the client account as representing payments made by the Legal Aid Agency must be:*
    - i. either recorded in the individual client's ledger account, and identified as the Legal Aid Agency's money;*
    - ii. or recorded in a ledger account in the Legal Aid Agency's name, and identified by reference to the client or matter;*

*and kept in the client account until notification from the Legal Aid Agency that it has recouped an equivalent sum from subsequent payments due to*

*you. The retained sum must be transferred to an office account within 14 days of notification."*

**Option D-** Simplify and shorten the Accounts Rules (as in option C) and remove the requirement for a separate client account.

This option is similar to option C, above, but it includes the more radical option of removing the requirement for solicitors to hold money in a separate client account.

The SRA position relating to regulation, in line with Government policy, is that if it is not possible to provide evidence to suggest that there is a sufficient rationale for keeping a requirement, it should be removed. It could be argued that, given the billions of pounds of client money that is held by practitioners and the comparatively small amount that is misused, the requirement to hold client money in a separate account is unnecessary. However, it could also be argued that removing this requirement may increase opportunities for the misappropriation of client money; for example, it might be easier for solicitors in financial difficulty to borrow client money from a mixed fund and remain undetected.

Some solicitors already experience difficulties keeping proper client account records when the funds are held in a separate account, it would be even more difficult to maintain records without a client account. It may also increase the burden of record keeping: it is likely that reconciliations of all office transactions as well as client transactions will be mandatory if funds are mixed. If this option were adopted, it is likely that practitioners would require some comprehensive retraining.

#### Option D draft rules

##### *"Accounts Rules for England and Wales*

1. *These rules apply to authorised persons regulated in England and Wales. MDPs are required to adhere to these rules in respect to regulated activities only.*
2. *You must:*
  - a. *use each client's money for that client's matters only;*
  - b. *use money held as trustee of a trust for the purposes of that trust only;*
  - c. *establish and maintain proper accounting systems and records, and proper internal controls over those systems;*
  - d. *pay interest when reasonable and in accordance with the policy set by the firm;*
  - e. *obtain and deliver annual accountant's reports as required by the rules.*
3. *All the principals in a firm must ensure compliance with the rules by the principals themselves and by everyone employed in the firm. This duty also extends to the directors of a recognised body or licensed body which is a company, or to the members of a recognised body or licensed body which is an LLP. It also extends to the COFA of a firm.*

4. *Any breach of the rules must be remedied promptly upon discovery by the principals of the firm. This includes the replacement of any money improperly withheld or withdrawn from a client account.*
5. *If, when acting in a client's matter, you hold or receive money jointly with the client, another practice or another third party, proper records must be maintained*
6. *In circumstances where you are jointly holding funds with another practice, both parties must keep proper records.*
7. *If you operate a client's own account, you must keep proper records as if it was client money.*
8. *A client (or other person who is entitled to client money) should:*
  - a. *have their money returned as soon as there is no longer any proper reason to retain funds;*
  - b. *be promptly informed in writing of the amount of client money retained at the end of a matter and the reason for the retention;*
  - c. *be informed in writing at least every twelve months thereafter of the amount of client money held and the reason for the retention.*
9. *The use of client money must relate to instructions on an underlying legal transaction which is (a) carried out by the practice and (b) of a type normally carried out by regulated persons.*
10. *Where the proper recipient of client money cannot be traced, a withdrawal of client money may be made only where the amount held does not exceed £500 in relation to any one individual client or trust matter and you:*
  - a. *establish the identity of the owner of the money, or make reasonable attempts to do so;*
  - b. *make adequate attempts to ascertain the proper destination of the money, and to return it to the rightful owner, unless the reasonable costs of doing so are likely to be excessive in relation to the amount held;*
  - c. *pay the funds to a charity. The practice should ensure that it has a deed of indemnity from the preferred charity so that funds may be refunded to the practice if called for;*
  - d. *record the steps taken in accordance with rule 9(a)-(c) above and retain those records, together with all relevant documentation (including receipts from the charity); and*
  - e. *keep a central register.*
11. *If money is paid to you by a client for a specified purpose, and not for your benefit, it must be used for that purpose.*

12. *Money withdrawn in relation to a particular client or trust must not exceed the money held on behalf of that client or trust (except as provided in rule 13 below).*
13. *You may make a payment in respect of a particular client or trust, even if no money (or insufficient money) is held for that client or trust, provided:*
  - a. *sufficient money is held for that client or trust in a separate designated client account; and*
  - b. *the appropriate transfer from the separate designated client account to a is made immediately.*
14. *Legal entities should have systems in place where only approved responsible persons are able to withdraw client funds.*
15. *You must have a written policy on the payment of interest, which seeks to provide a fair outcome. The terms of the policy must be drawn to the attention of the client at the outset of a retainer, unless it is inappropriate to do so in the circumstances. Interest must be calculated to cover the whole period for which the money is held.*

#### *Payments from the Legal Aid Agency*

16. *Regular payments from the Legal Aid Agency must be paid into an account in England and Wales.*
17. *You must within 28 days of submitting a report to the Legal Aid Agency, notifying completion of a matter pay any unpaid professional disbursement(s)*

*unless the Legal Aid Agency permits you to submit reports at various stages during a matter; in which case, the requirement above applies to any unpaid professional disbursement(s) included in each report so submitted.*
18. *If the Legal Aid Agency has paid any costs to you or a previously nominated firm in a matter (advice and assistance or legal help costs, advance payments or interim costs), or has paid professional disbursements direct, and costs are subsequently settled by a third party:*
  - a. *The entire third party payment must be treated as client money.*
  - b. *A sum representing the payments made by the Legal Aid Agency must be treated as client money.*
  - c. *The sum treated as client money as representing payments made by the Legal Aid Agency must be recorded as such:*

*until notification from the Legal Aid Agency that it has recouped an equivalent sum from subsequent payments due to you."*

**Option E** - Adopt a *de minimis* approach: Disapplying certain rules to firms which only use client accounts sparingly (e.g. if the amount in the client account at any one time does not exceed a certain threshold and/or a total level during the financial year).

This option could reduce unnecessary burdens and result in better targeted regulation. It could be operated in a way that would be consistent with the SRA's decision to exempt firms with an average client account balance of £10,000 or less from the obligation to obtain accountant's reports. This proposal has been made because such firms are perceived to be low risk.

This would fit in well with the SRA's recent focus on supporting small firms. However, it could also be argued that small firms are not necessarily lower risk and it may be difficult to set the appropriate financial threshold.

## **Option F - additional option - the removal of rule 1.2, which places duties on COFAs**

Adopting this option and removing this rule would remove the duplication of the obligation currently on the COFA. The obligation already rests on the COLP and principals/managers in the practice. It is open to the COLP to delegate elements of financial control and reporting to the COFA while retaining primary responsibility. A separate onus on the COFA is unnecessary. However, it may be argued that placing requirements on non-solicitors encourages good behaviour throughout the firm.

Rule 1.2 of the SARs currently reads as follows:

*"You must comply with the Principles set out in the Handbook, and the outcomes in Chapter 7 of the SRA Code of Conduct in relation to the effective financial management of the firm, and in particular must...": (underlining added)*

## **Conclusion**

The SRA is expected to launch a consultation reviewing the Accounts Rules in Spring 2016. The Law Society is keen to hear the views of the profession and use these to as a starting point to develop the Society's policy position. With this in mind, we have deliberately refrained from recommending any of the options. The resulting policy position will be used in negotiations with the SRA.

We would be grateful if members could answer the following questions:

- Question 1.** Which out of options A - F would you favour and why?
- Question 2.** Which out of options A - F would you least favour and why?
- Question 3.** Do you have any other comments or proposals on changes to the Accounts Rules?