Consultation

Looking to the Future: SRA Accounts Rules Review

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Looking to the Future: SRA Accounts Rules Review

Introduction

1. The SRA is the regulator of solicitors and law firms in England and Wales, protecting consumers and supporting the rule of law and the administration of justice. The SRA does this by overseeing all education and training requirements necessary to practise as a solicitor, licensing individuals and firms to practise, setting the standards of the profession and regulating and enforcing compliance against these standards. Further information is available at www.sra.org.uk.

2. Our regulatory reform programme includes a review of the SRA Accounts Rules 2011 ('the Accounts Rules'), which govern the handling of client money by those we regulate. The core purpose of the Accounts Rules is to ensure that money belonging to clients is kept safe. Our objective is to rationalise and simplify the rules. We aim to remove any unnecessary restrictions, prescription and detail while, at the same time, maintaining appropriate consumer protections. We have followed the same drafting principles as for our wider review of our Handbook[1].

Background

3. This is the third (and final) phase of our review of the Accounts Rules. Phase one came into effect in October 2014. This made minor changes to the format of the annual accountant's report that firms were required to obtain, and introduced an exemption for certain firms from the need to obtain that report[2]. We also removed the requirement for firms to submit to us reports where these found no failure to comply with the Accounts Rules. Phase two was implemented in November 2015, and encouraged reporting accountants to apply an outcomes-based approach to assessing compliance, with a greater focus on risks to client money. We also extended the exemption from the obligation to obtain an accountant's report to firms that have an average client account balance of no more than £10,000 and a maximum balance of no more than £250,000 over the accounting period[3].

4. The third phase has looked more widely at the existing Accounts Rules and makes proposals for broader change. The current Accounts Rules have not changed significantly for many years. They are prescriptive and restrictive, and focused on ensuring all firms handle money in the same way. In our view,

[1] We are consulting at the same time on Phase 1 of our Handbook Review including the Principles, Code of Conduct for Solicitors and Code of Conduct for Firms
[2] Where 100% of work is funded by legal aid
[3] For the rationale of the exemptions based on client account balance please refer to Phase 2 of our Accounts Rules review - see consultation document published November 2014 http://www.sra.org.uk/sra/consultations/reporting-accountant.page

the rules currently in force would not pass any assessment against the better regulation principles.[4]

5. Effective mitigation of the risk that client money will be misused has always been, and remains, a priority for the SRA. This is done through a combination of outcomes in the Code of Conduct; detailed provisions in the Accounts Rules for the separation and handling of client money, and obligations placed on a firm's managers and Compliance Office for finance and administration (COFA)[5].

6. However, the length and complexity of the current Accounts Rules makes it difficult for new entrants to the market to understand what is required of them as well as consumers to understand what to expect when a firm handles their money. Further, many firms find themselves in technical breach of the Accounts Rules in circumstances where there are no real risks to client money. For example, as highlighted in our earlier consultation[6] on reporting accountant's requirements, of the approximately 9000 firms that hold client money, in the period June 2012 to December 2013, over 50% received a qualified accountant's report but only 179 were referred to consideration for further regulatory action[7]. This suggests that our Accounts Rules are too complicated and are not focussed on the key risks to client money.

Proposals for change

7. We propose to:

- **Simplify the Accounts Rules**: by focusing on key principles and requirements for keeping client money safe, including:
    - keeping client money separate from firm money
    - ensuring client money is returned promptly at the end of a matter
    - using client money only for its intended purpose
    - proportionate requirements for firms to obtain an annual accountant's report.

[4] The better regulation principles require that regulators are proportionate, accountable, consistent, transparent and targeted

[5] Consumers also have access to the SRA Compensation Fund in the event that money is misappropriated or otherwise not accounted for (by a defaulting practitioner or their employee or manager). So while the Accounts Rules are intended to keep client money safe, there is an additional safeguard through the compensation fund.

[6] Consultation published June 2014 http://www.sra.org.uk/sra/consultations/reporting-accountant.page

[7] http://www.sra.org.uk/Solicitors_Regulation_Authority/sra/how-we-work/board/public_meetings/archive/SEP14_7_-_Reporting_Accountant_Requirements.pdf

This will put the focus on what is important and allow firms greater flexibility to manage their business. The Accounts Rules will also be simpler and easier to understand - increasing compliance and reducing compliance costs. A draft of the proposed Accounts Rules is provided at **Annex 1.1**. The Accounts Rules will be supported by an online toolkit which will comprise of guidance and case studies to aid compliance.

- **Change the definition of client money:** to allow money paid for all fees and disbursements for which the solicitor is liable (for example counsel fees) to be treated as the firm's money. Money held for payments for which the client is liable, such as stamp duty land tax, will continue to be treated as client money and therefore required to be held in client account. The impact of the proposed change in definition is expected to remove the need to have a client account for some firms and therefore reduce the associated compliance costs. The changes may also reduce the number of firms required to obtain an accountant's report through the subsequent reduction in the client account balance.

- **Provide an alternative to the holding of client money:** through the introduction of clear and consistent safeguards around the use of third party managed accounts (TPMA) as a mechanism for managing payments and transactions.

Links with our Handbook Review

8. The Accounts Rules are intended to work together with our new Principles and Codes of Conduct, which we are consulting on separately alongside this consultation.

9. Under the combined proposals we will have:

    - Standards that apply to all solicitors

    - Standards that apply to regulated firms

    - Accounts Rules that apply to firms we regulate, their managers and employees and who hold client money (as now more narrowly defined) or who have dealing with other money belonging to clients, for example through operating a client's own account as signatory or by their use of TPMA).

10. The proposed standards in our draft Code of Conduct for solicitors will apply to all individual solicitors, RELs and RFLs we regulate, wherever they work, and will require the following in relation to client money and assets:

    4.1 You properly account to ***clients*** for any ***financial benefit*** you receive as a result of their instructions.

    4.2 You safeguard money and ***assets*** entrusted to you by ***clients*** and others.

4.3 Unless you work in an ***authorised body***, you do not personally hold ***client money***.

11. The proposed Code of Conduct for Firms replicates standards 4.1 and 4.2.

12. The requirement to safeguard money and assets entrusted by clients is deliberately drafted to be wider than the proposed definition of client money. So while the Accounts Rules will be focused on client money held by firms we regulate, all solicitors and firms will be bound by these wider duties in the Codes of Conduct along with our Principles. **Annex 1.5** includes an example case study which highlights the obligation set out in the Codes of Conduct to safeguard monies and assets.

13. There are a number of other standards in the draft Codes of Conduct that mitigate the risks involved in dealing with client money[8]. For example, solicitors will be required to give their clients information in a way they can understand, explain the options available to them and provide the best possible information about pricing[9].

14. As the handling of client money remains a high risk area, we believe that it remains necessary to have separate Accounts Rules to address those risks. The Accounts Rules set out our expectations as to how client money should be kept safe, and the systems and controls, and accounting processes we expect to see. We therefore propose to retain a standalone set of Accounts Rules applicable to all SRA authorised firms and their employees and managers, compliance with which is also the responsibility of the firm's COFA (Compliance Officer for Finance and Administration).

Consultation questions

Question 1: Do you consider that the draft Accounts Rules (Annex 1.1) are clearer and simpler to understand and easier to comply with?

A new definition of client money and client liability

Our proposal

15. While the proposed simplification of the Accounts Rules (set out in paragraph 7) will remove much of the prescription within the Accounts Rules and offer firms greater freedom in how they manage their accounts, it does not address the core issue of what money should be protected by the Accounts Rules. We have therefore reviewed the definition of client money and are proposing a change to the definition which we consider strikes a better balance between consumer protection and regulatory burden.

[8] These include the duty to *ensure clients understand whether and how the services you provide are regulated and the protections available to them (outcome 8.9)*
[9] Draft SRA Code of Conduct for Solicitors, RELs and RFLs [2017], 8.6 and 8.7

Draft Rule 2.1:

"***Client money***" is money held or received by you:

(a) relating to legal services delivered by you to a *client*, excluding payments for your fees and payments to third parties for which you are liable;
(b) on behalf of a third party in relation to legal services delivered by you (such as money held as agent, stakeholder or held to the sender's order);
(c) as a trustee or as the holder of a specified office or appointment, such as a donee of a power of attorney, *Court of Protection deputy* or trustee of an occupational pension scheme.

16. Under the proposed definition, if a firm is holding money on behalf of a client (for example estate monies held in connection with a probate) or where the client has provided funds to cover their liabilities to a third party (for example in relation to residential property transaction to pay Stamp Duty Land Tax or completion monies) - that money will still be considered client money and must therefore be paid into client account. If the payment relates to legal services being provided by the firm to the client (for example fees paid by the client in advance) or services rendered on behalf of the client for which the firm is liable (for example costs relating to the client's matter which might include medical expert fees, counsel fees, or indirect costs such a courier fees) - it does not have to go into client account.

17. The proposed change in definition allows us to dispense with the current detailed descriptions in the Accounts Rules about different types of disbursements as well as the definition of office money and office account. How a firm manages its money should be for the firm to consider having regard to its other obligations in our Accounts Rules, any legal obligations and its assessment of its own financial stability. Where necessary we have instead referred to the firm's own money or to business accounts rather than office money and office account.

Consultation questions

Question 2: Do you agree with our proposals for a change in the definition of client money? In particular, do you have any comments on the draft definition of client money as set out in the draft Rule 2.1 (see Annex 1.1)?

Rationale

18. Under the current definition of client money, we treat fees paid in advance (which is client money) differently to fixed fees (which are not). This is an odd distinction which has evolved over time. Unlike the case in many other markets, solicitors routinely request payment in advance or on account of their fees or for other payments they may be required to make to third parties on the clients' behalf prior to completion of the work or before the client has been billed. Our Accounts Rules facilitate and normalise the payment of

money in advance in this way and require that it is held in client account. But from a consumer perspective, the payment for services in this way is at odds with the way they purchase many other services. And for firms, it does not provide much flexibility for different approaches and business models. For instance, for Multi-Disciplinary Practices (MDPs) operating under ICAEW rules as well as our own – the current definition causes issues in relation to the treatment of fees as ICAEW rules on client money do not make the same distinction between agreed fees and payment of account of costs. Under ICEAW rules, fees paid in advance for professional work agreed to be performed and clearly identifiable as such shall not be regarded as client' money[10].

19. We want both firms and consumers of legal services to have a range of options available to them. We already know that consumers are increasingly opting for fixed fee services. Research shows that use of fixed fee arrangements has increased from 38% to 46%[11] of legal transactions. When both the cost itself and uncertainty about cost are two of the most significant barriers to consumers accessing legal advice, fixed fees are a good thing. They allow consumers to know what the work will cost up front and to have certainty over those costs. This makes it easier for consumers to compare costs and shop around.

20. Under the current Accounts Rules, payments for fixed or "agreed" fees can be paid into the office account even if the work has not yet been done whereas payment for services that have not yet been billed must be treated as client money (and paid into client account).

21. We are therefore proposing to simplify our approach so that all payments for fees are treated the same under our Accounts Rules.

22. We do not think it is the right approach to change our position on fixed fees so as to require these payments to be paid into client account because they are fees for a service.

23. The level of protection currently applied to payment of fees in advance under the current Accounts Rules is significant. It ensures that this money is kept separate from the firm's money and in the event of the firm's insolvency is capable of being returned back to the client if the work has not been done (by the appointed insolvency practitioner or through use of our intervention powers). However it also adds costs through the requirement to maintain a separate client account just for these payments and comply with our Accounts Rules.

[10] Under ICAEW Rules - 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 – see http://www.icaew.com/en/members/regulations-standards-and-guidance/practice-management/clients-money-regulations

[11] http://www.legalservicesconsumerpanel.org.uk/publications/research_and_reports/documents/Choosing_legal_services_000.pdf

24. It is arguable that our Accounts Rules - in making separate provision for payment of fees in this way - may encourage or normalise the business practice of requiring consumers to pay in advance for services and before the costs have been calculated. The impact of this may be to increase the amount of money in client account in the first place and potential risks to consumers if that money is lost.

25. This issue is finely balanced but overall we consider that wider developments in consumer protection mean that we can safely reduce the current high levels of consumer protection provided in relation to fees paid in advance. For instance, consumers may choose to pay by credit card and take advantage of the protections available in consumer legislation if the supplier does not provide the agreed services in part or in full (so long as the services were bought for between £100 and £30,000)[12]. A recent Financial Conduct Authority (FCA) market study found that 60% of consumers have at least one credit card. We are particularly interested in views on how the market may react to the use of credit cards for payments, for example whether firms currently facilitate payment by credit card or the extent to this may change. We are also interested in whether there are any impacts in terms of access to credit cards among certain socio-economic groups.

Consultation question

Question 3: Do you have any views on the use of credit cards to pay for legal services? If you are a firm, do you accept credit card payments? If not, why not? If you are a consumer, would you use a credit card to pay for legal services? If not, why not?

26. Where firms continue to require payment in advance or consumers cannot pay by credit card, consumers also have access to redress through the Legal Ombudsman in certain circumstances if something goes wrong[13]. Under the current arrangements, consumers (if eligible[14]) would also have the ability to claim on our Compensation Fund (which is not currently restricted to the definition of client money). For example, if a firm becomes insolvent and a firm was intervened into we would return money collected from the firm's client account (via our Statutory Trust powers). For any money not held in client account (as would be the case for fees or payments to third parties where the work has not yet been done) - consumers would be apply to apply for a payment from our Compensation Fund. The subsequent risk however is that we would see an increase in claims on the fund as a result. This is an issue we will need to consider separately as part of our review of professional indemnity insurance and compensation arrangements later this year.

[12] Section 75 of the Consumer Credit Act. A consumer guide to what to expect has been produced by the UK cards Association http://www.theukcardsassociation.org.uk/wm_documents/creditcard_yourights_a_consumer_guide%281%29.pdf

[13] Redress mechanism via LeO for financial loss, distress and inconvenience (up to £50k)

[14] See Rule 3.7 of the SRA Compensation Fund Rules 2011

Payments to third parties

27. Solicitors quite often handle payments relating to the case on a client's behalf - for example payments to other lawyers, professional experts and counsel . They may also handle payments for courier charges or other associated fees such as Land Registry search fees. These are currently referred to in our Accounts Rules as disbursements and the rules distinguish between professional disbursements (which are client money) and other types of disbursements (which are not client money).

28. As with our approach to fees, we are proposing to simplify this position in the Accounts Rules. Payments for professional services for which the firm is liable should in our view be treated as any other liability of the firm. We have included, for the avoidance of doubt, an express reference in the draft rule (Rule 2.1) to client money excluding payments in advance for fees and payments to third parties for which the firm is liable.

29. We recognise this is a change for firms in terms of the way they manage their businesses and accounting systems. We therefore welcome views from firms as to the specific impacts of this proposal.

Risks in our approach

30. We recognise that our proposals for the definition of client money represent a potential reduction in consumer protection if clients continue to pay for costs in advance and do not pay for these by credit card. In the event that work is not completed, clients would have access to redress through the Legal Ombudsman (LeO) but this takes time and effort to pursue. There are also risks to the client if payments to third parties are not paid by the firm – for instance it might mean that client matter is not progressed as it should. However, for the reasons set out we consider the proposed approach offers a better balance between consumer protection and regulatory burden.

31. We think the revised definition of client money is clearer and focuses protections where the potential harm to consumers of the money being lost are significant, such as property transactions and probate. This is supported by data from the Compensation Fund which shows we have paid out over £3m for payments associated with property transactions in the past two years[15]. We consider that this money must therefore be paid into a client account and be kept there until properly withdrawn.

32. We accept that the proposal removes some protections for those other than the clients (for example Counsel and other experts). We consider that these risks in relation to payments for which the solicitor is liable are adequately addressed through clear duties to act in the client's best interests. We would therefore expect:

    - sufficient accounting records of transactions kept by the firm including client transactions through the firm's business accounts

[15] Data from the Compensation Fund shows we paid out over £3m for payments consumers were liable for to HMRC and the Land Registry.

- firms to comply with the standards required in respect of giving adequate cost information, delivering bills, and returning any surplus costs or money promptly

33. This focuses less on where the money is held and more upon the responsibility to provide a good service to clients and to act in their best interests. Should the worst happen and money be lost and/or the client adversely affected, they have access to a range of consumer protections which have improved since the definitions of client money and office money were first put in place a number of years ago.

34. We have presented some examples of the risks posed to consumers and potential impacts at **Annex 1.4** along with the initial Impact Assessment. We welcome views on our assessment of these risks. In particular, we would welcome views on whether we have identified the main detriments and whether that on balance the risk is more than mitigated by the potential redress mechanisms available, albeit we accept that they may take considerable time and determination for clients to pursue.

Flexibility and mixed payments

35. Two further related points arise from this proposal:

- A question of flexibility and whether or not only client money can be paid into client account (as in the current Accounts Rules) or whether there should be flexibility for clients to agree different arrangements;

- How we treat mixed payments – where there is a combination of client money and money that will belong to the firm.

Flexibility - the use of client account for other payments

36. Under the current Accounts Rules, only client money is permitted to be held in client account. While mixed payments may be paid into client account in the first instance, any portion that is deemed to be office money must be transferred out of the client account within 14 days of receipt[16].

37. We are seeking views on whether or not only client money (as redefined) can continue to be paid into the client account or whether there should be flexibility for clients to agree different arrangements. For example, if a client wants to make payments for fees in advance or for those monies to be reserved from a previous settlement, whether these could be paid into client account?

38. Our preliminary view is that we should retain the current approach. This is because it is clearer to apply and could also be problematic in terms of an intervention into a firm as we would have difficulties with identifying what money is genuinely client money over which we have statutory powers and what money belongs to the firm. There is also the potential for funds belonging to the firm to be used improperly to conceal shortfalls in the client account or where client money should have been deposited in the client

[16] SRA Accounts Rules, Rule 18.3

account. We therefore consider that we should continue to apply the principle in the Accounts Rules that only client money can be held in client account subject to some very limited exceptions around the treatment of mixed payments.

Consultation question

Question 4: Do you consider it appropriate that only client money (as defined in draft Rule 2.1) should be held in a client account?

Mixed payments

39. The concept of mixed payments[17] relates to monies that are partially client money and partially money belonging to the firm, for example, where a solicitor receives a cheque for damages due to a client, their fees and other disbursements. The current Accounts Rules relating to mixed payments, while detailed, are designed to address the risk of client money being wrongly held in office account for lengthy periods of time. This risk does not fall away under a change to the definition. Mixed payments will continue to exist under the proposed changes to the definition; in fact the likelihood of a firm receiving mixed payments is likely to increase as a result of the change. We are seeking views on whether mixed payments should continue to be paid into a client account first, as now, or whether we can be more flexible in the new Rules. For example, we could focus our rules on where the money ends up rather than where it is paid into in the first instance.

40. Our current view is that a degree of flexibility is desirable. We therefore propose to replace the existing prescriptive requirements that mixed payments must be paid into client account with a broader requirement requiring mixed payments to be allocated promptly to the correct account whether that is client account or a business account.

Consultation question

Question 5: Do you agree with our proposal that mixed monies can be paid into client or business account as long as the funds are then allocated promptly to the correct account ? In particular do you have any the new draft Rule 4.2 (see Annex 1.1)?

Payments from the Legal Aid Agency (LAA)

41. The Accounts Rules (currently in force) set out two special dispensations which apply to legal aid payments:

    a. An advance payment, which may include client money, may be placed in an office account (provided the LAA instructs in writing that this may be done)

[17] SRA Accounts Rules, Rule 18

b. A payment for costs may be paid into an office account, regardless of whether it consists wholly of office money, or is mixed with client money in the form of:

   i. advance payments for fees or disbursements; or

   ii. money for unpaid professional disbursements;

   provided all money for payment of disbursements is transferred to a client account (or the disbursements paid) within 14 days of receipt.[18]

42. In addition, the firm on completion of a matter must pay any outstanding professional disbursements or transfer a sum for those amounts to the firm's client account.

43. With regards to money received from the LAA, our understanding is that firms would only ever receive money for payment on account of the firm's costs or for disbursements (for example, counsel's and expert fees). As set out above, these types of money will fall outside of the proposed new definition of client money and will therefore not be held in a client account. We would there propose to remove the specific Accounts Rules which deal with the treatment of LAA money.

44. We expect that the continued obligation to reconcile accounts and keep accurate records will ensure that any monies received and not utilised by the firm will be dealt with appropriately and returned to the LAA promptly where necessary . In addition, firms will be bound by the terms of their contract with the LAA and subject to the LAA's own Accounts Rules and monitoring regime. Of note, if the SRA was to intervene into a firm and it was established that work had not been done for which payment had been received then the SRA's statutory trust provisions would apply (meaning that monies will be returned to the LAA by the SRA). However, if the money was paid into an overdrawn office account there will be no claim on the Statutory Trust as the money will clearly have gone[19] and the loss would not be covered by the Compensation Fund[20].

45. We are discussing this position with the LAA to determine whether we can safely dispense with the specific Accounts Rules relating to payments from the LAA (currently Rule 19).

Consultation question

Question 6: Having regard to our proposed definition of client money, do you agree that we can safely dispense with the specific Accounts Rules relating to payments from the Legal Aid Agency (LAA)?

[18] http://www.sra.org.uk/solicitors/handbook/accounts/part4/rule19/content.page
[19] A claim on the Statutory Trust can only succeed if the money was there at the point of intervention – that is more likely to be the case with money in client account than in office account as intervened firms are invariably overdrawn.
[20] Rule 8.1 (h) of the SRA Compensation Fund Rules 2011

An alternative arrangement to holding client funds - TPMA

46. We have previously consulted[21] on our proposal to allow firms to use alternatives to holding client money, through the use of a Third Party Managed Accounts ("TPMA"). This would be an option for firms rather than a requirement. By this we mean accounts where a third party (a payment service provider) holds money on behalf of two or more transacting parties – in this case a third party would hold funds for a law firm or solicitor and their client. As our Accounts Rules apply to client money which is held or received by the solicitor or firm themselves, money held in a TPMA is not subject to our existing requirements.

47. In our previous consultation we asked whether our Accounts Rules should require that we approve each arrangement to use a TPMA on an individual basis or whether we should set general standards for those arrangements to meet. We suggested a list of desirable features that we thought TPMAs should satisfy[22].

48. There was broad support from respondents regarding the proposals. However, a large number of respondents felt this matter merited a separate, single-issue consultation. We therefore decided[23] to proceed with the development of Accounts Rules to permit TPMA but to incorporate this work into our wider review of the Rules and to use the briefing paper "Alternatives to Handling Client Money"[24] (compiled by the legal services regulators of England and Wales) to inform our work on TPMAs. In the meantime as our current Accounts Rules do not expressly prevent the use of TPMA, we decided to consider requests from firms on a case by case basis in order to satisfy ourselves that the arrangements were suitable[25].

Our approach to TPMAs

49. Our objective for allowing TPMA is to provide sufficient flexibility for firms to meet their obligation to safeguard client money and assets and alternative options for clients. This flexibility must be balanced with appropriate levels of consumer protection. The use of TPMA is relatively untested. We therefore need to consider the consumer impacts carefully. For instance, it may be that TPMA is only appropriate for use with certain types of clients or categories of work and not others. Or it may be the benefits of increased choice and access for those consumers that are currently excluded from the legal services market is sufficient justification to go ahead and allow TPMA in all

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[21] TPMA consultation - http://www.sra.org.uk/sra/consultations/regulatory-reform-programme.page

[22] Independence of the third party from the transacting parties, transparency of status and ownership of the third party, a third party regulated by the Payment Services Regulator, clear mechanisms for dealing with disputes, clear provisions for termination of the arrangement

[23] http://www.legalservicesboard.org.uk/projects/statutory_decision_making/pdf/2015/20150917_Annex_2_SRA_Board_Public_Item_8_Improving_Regulation.pdf

[24] http://www.legalservicesboard.org.uk/what_we_do/pdf/20150720_Proposals_For_Alternatives_To_The_Handling_Of_Client_Money.pdf

[25] http://www.sra.org.uk/documents/SRA/board-meetings/2015/board-2015-09-09-improving-regulation.pdf

circumstances. Our starting point for TPMA has been to look at the extent to which these services are regulated already.

50. Not all escrow service providers are regulated as financial service providers. Therefore we are suggesting restricting TPMAs to those operated by payment services providers which are FCA regulated under the Payments Services Regulations 2009. As TPMAs are already subject to regulation by the FCA, we see no reason to place additional requirements relating to the providers of those services. We therefore propose to allow firms to use a TPMA if:

    a. the TPMA is either an authorised payment institution and a result has mandatory safeguarding arrangements, or is a small payment institution which has adopted voluntary safeguarding arrangements; and,

    b. they can demonstrate that the firm has suitable arrangements for the implementation, use and monitoring of TPMAs. For example that use of TPMAs is suitable for the types of transactions, appropriate information is provided to clients and appropriate internal controls are in place.

51. Our draft Accounts Rules (**Annex 1.1**) set out the arrangements we propose to introduce to enable firms to use a TPMA in order to mitigate any risks to the client as the end user:

- the provision of information to the client, especially prior to entering into a TPMA arrangement, to ensure a clear understanding of the terms of the contract and the right to terminate the agreement;
- the requirement to cooperate with the SRA and to maintain proper financial records; and,
- arrangements for interest payments.

FCA Regulation of TPMAs

Payment service providers are regulated by the FCA as a payment institution under the Payment Services Regulations 2009 (PSR).

However, the level of regulation differs depending on whether the TPMA is an authorised payment institution or a small payment institution. Small payment institutions (which have a monthly payment value of less than Euro3m) are not subject to mandatory safeguarding arrangements but can choose to adopt safeguarding requirements.

There are 2 ways in which payment institutions can choose from to safeguard. They are:

The segregation method which requires funds to be held separate from all other funds. Either in an authorised credit institution authorised by the FCA or invested in secure liquid assets held by an authorised custodian. The safeguarding account must be named in a way that shows it is a safeguarding account and not used to hold any other funds or assets. Funds safeguarded in this way are protected from the claims

of other creditors;

a. The insurance or guarantee method by which the funds are covered by an insurance policy with or guarantee from an authorised insurer payable in an insolvency event.

A payment institution must maintain systems and controls that minimise the risk of loss or diminution of relevant funds or assets through fraud, misuse, negligence or poor administration and be managed by individuals who possess appropriate knowledge and experience and are of good repute.

Funds held in a segregated account with an authorised credit institution will be subject to the FCS guarantee. All payment institutions are subject to FCA Rules on handling complaints and consumers and micro-enterprises have access to the Financial Ombudsman Service. However to ensure that a firm's clients have access to FOS the agreement between the firm, the client and the TPMA provider may need to contain appropriate terms. Payment institutions are subject to conduct of business requirements relating to the information to be provided to the customer in relation to transactions and rights and obligations. However these will not protect the firm's client unless the contract contains appropriate terms.

Market viability of TPMAs

52. TPMAs initially developed with a focus on costs, disbursements and settlement monies. This is due to the speed and costs of the service, which made it less suitable for transactional payments.

53. If we proceed with the proposed change to the definition of client money set out in this consultation, it is likely the drivers for using a TPMA will change. If firms are able to hold fees paid in advance and certain disbursements outside of client account, it is perhaps unlikely that they will choose the additional costs of operating a TPMA for these funds.

54. The success of the TPMA market will of course depend on TPMA providers offering a service in a way that is commercially attractive to firms (and their clients) as an alternative to holding a client account, and which offers sufficient speed and security of transactions. It may also be affected by other incentives such as the reduction of premiums for professional indemnity insurance. This is something we are considering as part of our impact assessment.

Consultation questions

Question 7: Do you agree with our approach to allowing TPMAs as an alternative to holding money in a client account?

Question 8: If not, can you identify any specific risks or impacts of allowing TPMA that might inform our impact assessment?

Question 9: Do you consider it appropriate for TPMAs to be used for transactional

monies – particularly in relation to conveyancing? Or should the use of TPMA be restricted to certain areas of law? If so, why?

Key changes in the new Accounts Rules?

55. Key changes that we have proposed in the Accounts Rules include:

- removing the current reference to the Accounts Rules applying only to practice from an office in England and Wales as well as references to Exempt European Practices (EEPs). This is because of the proposal to allow solicitors to practice in firms that are not regulated by the SRA. We are consulting separately on the impact of these changes on the current EEP regime and whether there will be a continued need for an approval regime to allow RELs to do so in circumstances where they are providing foreign legal advice and unreserved services.

- removing the reference in the current Accounts Rules (Rule 1) to the SRA Principles thereby removing the potential for confusion about the scope of the COFA's responsibility extending to compliance with conduct requirements.

- key principles for when withdrawals from client account can be made, based around the purpose for which the client money is being held and a much simpler requirement that other withdrawals can be made in circumstances that we prescribe. This will allow us to place the detail of the thresholds and safeguards into more flexible and expanded guidance

- The duties to remedy have been retained as we consider that they are important

- The existing requirement on firms to ensure that they have a written policy on the payment of interest will be removed and reflected in provisions in the draft Code of Conduct of Solicitors (standard 8.8).

- Rule 8 sets out client accounting systems requirements. We have retained the requirement to obtain bank statements and do 5 weekly reconciliations as we consider that both are important mechanisms to ensure firms, their reporting accountants and our supervisory and enforcement functions can check compliance.

56. Rule 12 sets out the requirements on firms to obtain and deliver accountant's reports. Although recently reviewed and amended as part of Phase 2 of our review, we have taken the opportunity to reduce the length and detail of the applicable Accounts Rules. In particular, we are very interested to hear about the practical application of the current exemptions for small amounts of money held and whether the maximum limit of £250,000 is necessary. Finally, we have removed the existing Rule 47 dealing with production of documents and information as the provisions are already set out in the draft Codes of Conduct for Individuals and Firms.

57. Later this year we will have the opportunity to review the implementation of the Phase 2 changes and we will consider any issues that review raises alongside the responses to this consultation.

What do the Accounts Rules not contain?

58. We have removed detailed references in the Accounts Rules to those taking appointments such as Court of Protection Deputies and as Trustees of an Occupational Pension Scheme. We have simplified the Accounts Rules by confirming that monies held by these appointees are client money and the Accounts Rules therefore apply in full (including the requirements to pay interest), subject to any conflicting obligations to comply with the relevant statutory schemes. We have also removed references to circumstances where solicitors take insolvency appointments. Where a solicitor takes an insolvency appointment in a bankruptcy matter or company liquidation then they are required to pay all money received in the course of carrying out their functions into the Insolvency Services Account (ISA) kept by the Secretary of State. Voluntary liquidators may deposit funds into the ISA.

59. Finally we have replaced the specific waiver provision about accountants' reports with a more general and flexible approach to waivers as will be set out in our waivers policy.

Consultation questions

Question 10: Do you have any views on whether we need to retain the requirement to have a published interest policy?

Question 11: Do you have any comments on the draft Accounts Rules, either as a whole or in relation to specific Accounts Rules (see Annexes 1.1, 1.2 and 1.3)?

Support package for firms

60. We appreciate that some firms prefer a more detailed approach and we intend to issue an online support package for firms. The toolkit will provide firms with a range of tools and resources (guidance on key topics, case studies and questions and answers) to help them understand the regulatory requirements and deliver services in a compliant way. Moving the current guidance notes from the Accounts Rules to separate documents will allow us to regularly update them in line with other developments. **Annex 1.5** sets out an indicative list of areas that we will issue guidance on and example case studies. We welcome feedback on the areas we have identified and on other areas that guidance or case studies might be useful.

61. The toolkit will not form part of the SRA Handbook. How firms use the toolkit will depend every much on their size, the activities they engage in and the needs of their clients.

62. We will also be reviewing the materials produced as part of Phase 2 changes to the reporting accountant requirements (including the AR1 Form) – as these are based upon the current Accounts Rules.

Consultation question

Question 12: Are there other areas relating to the Accounts Rules that should be included in the toolkit for firms through guidance or case studies? If yes, please provide further details.

Impact of our proposals

63. An initial high level impact assessment has been developed and should be reviewed alongside this consultation. This sets out the SRAs early assessment of the likely impact of our proposals primarily on firms and consumers. We would welcome views from respondents, with a particular emphasis on any data or evidence that will assist us in finalising our impact assessment.

Consultation questions

Question 13: Do you agree with our assessment of the consumer impacts in Annex 1.4? Do you have any information to inform our understanding of these risks further?

Question 14: Is there any information, data or evidence that you can provide or direct us towards that will assist us in finalising our impact assessment?

Next steps and implementation timetable

64. This formal consultation is open for sixteen weeks, closing on 21 September 2016.

65. In line with our published consultation policy, we will pro-actively target and facilitate discussion with key stakeholders, including firms likely to be affected by these proposals.

66. Our second consultation on the SRA Handbook will set out details in relation to the implementation of rules.

Annex 1.1 - Draft SRA Accounts Rules [2017]

Annex 1.2 - Draft SRA Account Rules glossary

Annex 1.3 - Destination table

Annex 1.4 - Consumer Protection analysis

Annex 1.5 - Indicative list of guidance areas and example case studies

Consultation questions

Question 1: Do you consider that the draft Accounts Rules (Annex 1.1) are clearer and simpler to understand and easier to comply with?

Question 2: Do you agree with our proposals for a change in the definition of client money? In particular do you have any comments on the draft definition of client money as set out in the draft Rule 2.1?

Question 3: Do you have any views on the use of credit cards to pay for legal services? If you are a firm, do you accept credit card payments? If not, why not? If you are a consumer, do you use a credit card to pay for legal services? If not, why not?

Question 4: Do you consider it appropriate that only client money (as defined in draft Rule 2.1) should be held in a client account?

Question 5: Do you agree with our proposal that mixed monies can be paid into client or business account as ling as the funds are then allocated promptly to the correct account ? In particular do you have any the new draft Rule 4.2 (see Annex 1.1)?

Question 6: Having regard to our proposed definition of client money, do you agree that we can safely dispense with the specific Accounts Rules relating to payments from the Legal Aid Agency (LAA)?

Question 7: Do you agree with our approach to allowing TPMAs as an alternative to holding money in a client account?

Question 8: If not, can you identify any specific risks or impacts of allowing TPMA that might inform our impact assessment?

Question 9: Do you consider it appropriate for TPMAs to be used for transactional monies – particularly in relation to conveyancing? Or should the use of TPMA be restricted to certain areas of law? If so, why?

Question 10: Do you have any views on whether we need to retain the requirement to have a published interest policy?

Question 11: Do you have any comments on the draft Accounts Rules, either as a whole or in relation to specific Accounts Rules?

Question 12: Are there other areas relating to the Accounts Rules that should be included in the toolkit for firms through guidance or case studies? If yes, pleas provide further details.

Question 13: Do you agree with our assessment of the consumer impacts in Annex 1.4? Do you have any information to inform our understanding of these risks further?

Question 14: Is there any information, data or evidence that you can provide or direct us towards that will assist us in finalising our impact assessment?

How to respond to this consultation

Online

Use our online consultation questionnaire[26] to compose and submit your response. (You can save a partial response online and complete it later.)

Email

Please send your response to consultation@sra.org.uk. You can download and attach a Consultation questionnaire.

Please ensure that

- you add the title "SRA Accounts Rules 2017" in the subject field
- you identify yourself and state on whose behalf you are responding (unless you are responding anonymously)
- you attach a completed About You form
- you state clearly if you wish us to treat any part or aspect of your response as confidential.

If it is not possible to email your response, hard-copy responses may be sent instead to:

Solicitors Regulation Authority
Regulation and Education - SRA Accounts Rules 2017
The Cube
199 Wharfside Street
Birmingham
B1 1RN

Deadline

Please submit your response by 21 September 2016.

Confidentiality

A list of respondents and their responses may be published by the SRA after the closing date. Please express clearly if you do not wish your name and/or response to be published. Though we may not publish all individual responses, it is SRA policy to comply with all Freedom of Information request.

[26] https://forms.sra.org.uk/s3/accounts-rules-review