DISCUSSION PAPER: SEPARATE CLIENT ACCOUNTS

Response of the Sussex Law Society

A sub-committee of the Sussex Law Society, set up for the purpose, has considered the Law Society's discussion paper on separate client accounts. What follows represents the views of that sub-committee.

The paper asks if members of the Society agree that:

- Solicitors' client accounts pose no more risk that third party managed accounts;
- Given the option, solicitors are unlikely to use alternatives to client accounts; and
- There could be significant unintended consequences associated with even a permissive change; for example, there could be an unwelcome impact on the Solicitors' Compensation Fund.

The questions arise from the SRA's consultation on a proposed permissive change to the Handbook to allow solicitors to use third party managed accounts as an alternative to handling client money, and the proposal to consult more widely following concerns raised by the Law Society and other stakeholders to the initial consultation.

The proposal itself arises from a perception by the joint regulators that holding client's money is an activity which generates considerable consumer risk and a large quantity of regulation. A risk of this kind to consumers is, by its very nature, a risk to solicitors, and one that solicitors wish to keep to a minimum – a wish which is, to a large extent, fulfilled. Whilst regulation is a burden to the profession and it remains desirable to minimise it too, the sub-committee felt, in line with at least some of the results of the LSB's 'cost of regulation' research referred to in the paper, the regulation attributable to client accounts/money is a price worth paying for exceptional consumer protection, the protection of practitioners, and the maintenance of consumers' confidence in the profession.

Whilst some of the administrative burden might shift (from those responsible for compliance to those dealing with daily transactions) if third party managed accounts were substituted for client accounts, the sub-committee were unconvinced that, overall, that burden would be diminished. Indeed, in many respects, for example in connection with individual transactions, particularly those involving property and especially residential property, the involvement of the client and a third party in the movement of client money is likely to increase administrative burden, complexity, risk of error and delay. It is difficult to see, for example, that severe practical difficulties would be avoided on completion day in residential conveyancing transactions if a

solicitor, the third party holding the escrow account, and the client were all required to release funds. If, in order to avoid some of that difficulty, the client's authority to release money were obtained in advance, much of the 'protection' the measure is intended to provide would be removed.

Solicitors are well used to regulation and, whilst it can be onerous, it is one of the profession's unique selling points in terms of protection for consumers. It is important to avoid deregulation for deregulation's sake, unless there are genuine practical benefits which do not themselves result in a reduction in protection for consumers and, therefore, the profession itself.

Little consideration seems to have been given by the joint regulators to the actual incidence of relative cost. The sub-committee has not made any enquiry into either the potential cost savings that might derive from the abandonment of client accounts, or the costs of running escrow accounts, although it notes that the paper states that they are 'likely to be prohibitively expensive for most solicitors'. The additional work of moving money controlled by a third party, and needing a client's release, is likely to add considerably to the time and cost of completing transactions, and increase the risk of chains of property transactions being disrupted.

In addition to the cost benefit to firms, noted in the discussion paper, that result from the fact of their holding client accounts with banks, and the actual cost of using escrow accounts, the loss of interest derived from the difference between that earned from banks and that paid to clients under current rules is also a cost which could impinge negatively on charges.

Question 1

'Solicitors' client accounts pose no more risk than third party managed accounts'

The sub-committee has seen no convincing evidence that third party managed accounts would pose a significantly reduced risk over client accounts to warrant the increased practical difficulties and, potentially, cost in using them. It seems that the regulators have presented little such evidence. Nor have they presented evidence or argument that such accounts would provide significant benefit. Indeed, it seems likely that third party managed accounts could pose a greater risk in that providers may not be subject to the same levels of protective regulation that surrounds solicitors' client accounts. Further, the introduction of additional confusion and complexity in terms of the different agencies and compensation schemes that would be involved when things went wrong would be a negative development.

It is not necessary solely financial risk that is at stake. It seems likely that the increased practical problems of dealing with third party managed accounts in transactions would increase the risk of errors and delay, which could cause significant disruption and loss to clients.

Further, solicitors will inevitably be very cautious about giving undertakings – the bedrock of transactional work – if they do not have absolute control over the movement of money. Such undertakings as are given, are likely to be more qualified and, therefore, less reliable than hitherto. This will have a significant negative impact on the practicality of dealing with this kind of work, and on the risks involved for both consumers and solicitors.

There is evidence from the Legal Services Consumer Panel that clients value – and are prepared to pay for – the protections offered by the current system, and in the absence of compelling evidence that equivalent protections would be available under the escrow system, clients will be less well served overall by changing to something new.

The sub-committee was concerned about the levels of 'misuse of client money or assets' referred to in the 'Financial Risk' section of the discussion paper, despite the context of the overall size of the market. The headline figure of 140 reports per month, and claims of £24.69 million against the Compensation Fund in 2014 is alarming, although these figures are put somewhat in context by the fact that they resulted in only 300 cases of regulatory action being taken in the same period. It may be that significant numbers of the monthly reports were for minor breaches of rules, rather than substantive misuse of client money, although the claims figure is still disconcerting. The sub-committee felt that every effort should be made, by means other than removing the ability to hold client funds, to combat the levels of breaches and claims.

The sub-committee felt that such financial risks as there are in the current system are modest in relation to the overall market, and whilst they should be addressed in other ways, overall client accounts pose no more risk than third party managed accounts, and, there is a likelihood that the third party accounts would actually increase the risk and cost of transactional work.

Question 2

'Given the option, solicitors are unlikely to use alternatives to client accounts'

A system that is voluntary will only be adopted by those who perceive an overall benefit. That benefit might accrue to solicitors themselves, or to their clients, or both. But, without a benefit, there will be no take-up of the option.

The potential benefits to clients are, at best, questionable. Whilst there may be some reduction in the risk of 'dipping in' (which should be addressed in other ways), there would seem to be little chance of escrow accounts reducing the risk of large scale dishonesty and determined theft. Any such benefit as there is must be weighed against the disadvantages, such as the real possibility of additional cost – the joint regulators view that costs might be saved seems illusory; the inevitability of severe practical difficulties in transferring funds in transactions; the added complexity

of different aspects of transactions being regulated by different regulators and subject to different claims processes; and damage to the public's confidence in the profession which is likely to arise from the implication that it cannot be trusted with client money.

Further, there may be additional practical difficulties in transactions if some solicitors continued to hold client accounts, while others employed escrow accounts instead. On the other hand, a firm that held no client accounts might be less exposed to attack by fraudsters.

The sub-committee felt that there was little prospect of solicitors taking up an option to dispense with client accounts in favour of third party managed accounts.

Question 3

'There could be significant unintended consequences associated with even a permissive change; for example, there could be an unwelcome impact on the Solicitors' Compensation Fund'

The suggestion that contributions to the Compensation Fund might be reduced if client accounts were outlawed does not seem to be backed up with evidence that claims would be reduced. Reductions not based on reliable calculations of future liabilities could result in shortfalls which would have to be made up by surcharges, and would be unwelcome. Shortfalls in the Fund would not be good for consumers, or for public confidence in the profession.

A permissive change will not result in universal take-up. One consequence will be the practical difficulties of dealing with two systems noted above, which would be exacerbated in chains of transactions.

However, if a permissive change proved unpopular, the likelihood of unintended consequences proving material would diminish.

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