Submissions on proposed Solicitors Accounts Regulations

DSBA

Submissions to Law Society of Ireland

**1.0****Background:**

The Law Society intends to introduce new Solicitors Accounts Regulations in 2022 and has asked Bar Associations for submissions.

DSBA welcomes the opportunity to make submissions to the Law Society on the proposed changes.

**2.0 ABOUT THE DSBA**

**(THE DUBLIN SOLICITORS BAR ASSOCIATION)**

The Dublin Solicitors’ Bar Association (‘DSBA’) was established in 1935 and is the largest independent association of Solicitors in Ireland, with a membership of over 3,000 practitioners.

DSBA is a representative and education body for Solicitors and does not hold any regulatory function. Our membership includes Solicitors’ firms of all sizes, from sole practitioners to the largest firms in Ireland and we are the largest independent provider of continuous professional development courses for Solicitors in Ireland.

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**3.0 EXECUTIVE SUMMARY**

DSBA is pro-regulation. Regulation of client money protects the clients, solicitors and enables the public to have confidence in the solicitors’ profession.

We have considered the new solicitors accounts regulations proposed by the Law Society of Ireland. We have not had the benefit of reviewing the regulatory impact assessment (‘RIA’) prepared by the Law Society in respect of these proposed changes.

From the review carried out by DSBA there are a number of innovations which are very much welcomed – the overhaul of the regulations generally, the provisions relating to lodging controlled trust funds and non-controlled trust funds to the client account, the more regular balancing statement. These are helpful, practical and low-cost changes which will have the effect of making client money safer with a very small or with no additional burden on the practitioner.

There are other proposals however which concern the DSBA. Some changes may, in practice, create a disproportionate burden that will be placed on practitioners without really making client money safer and possibly compromising the professional secrecy required of solicitors – that is in respect of maintaining registers, additional records to be kept for the office account, maintaining real-time ledger cards and imposing additional AML-like requirements even when the work is not subject to AML legislation.

DSBA has identified two possible further innovations which might be considered by the Law Society when overhauling the Solicitors Accounts, that is the introduction of Third Party Managed Accounts.

Separately, the Solicitors Benevolent Association [‘SBA’] has come up with a practical way of dealing with small unclaimed balances on the client accounts of solicitors. The SBA proposal is that it would hold such balances on behalf of solicitors and refund to the solicitor or client in the event that the owner of the funds ever identifies themselves. This is a practical way of solicitors complying with Regulation 13(8) where there are longstanding unclaimed funds. The SBA would effectively hold such accounts in escrow on the understanding that they would not alienate the ownership of the property.

**4.0 INTRODUCTION**

Solicitors Accounts Regulations

It is a truth universally acknowledged that it is the compliant solicitors who pay for the non-compliant when it comes to misappropriation from a client account. Regulation of the client account is therefore essential for protection of client money, the reputation of solicitors and the Compensation Fund, which is maintained through contributions from solicitors.

It is to the credit of the careful stewardship provided by the Regulation Department of the Law Society that default in respect of Solicitors Accounts Regulations is rare, in comparison with the number of practitioners and the value of the transactions carried out by solicitors overall. For the period 1999 to 2018, there were 86 solicitors struck-off the Roll, most of the strike-offs relating to misappropriation of client funds. Given that there are over 20,000 solicitors on the Roll it is important not to lose sight of the fact that more than 90% of solicitors are compliant in respect of Solicitors Accounts Regulations [‘SARs’].

The SARs were last overhauled in the early part of this century. Given the pace of change in technology and banking since the last century, an update of the SARs is most welcome. Many of the changes in the proposed SARs are to reflect the environment in which we operate. Some changes are to reflect the update in terminology and banking procedure – for example, as well as retaining returned paid cheques, solicitors will, under the new SARs, be bound to retain a copy of the remittance advices from electronic fund transfers from the client account. This is sensible and no doubt already adopted by most solicitors as a matter of good practice.

There are a number of other welcome innovations also in respect of, for example, being permitted to lodge controlled trust funds and non-controlled trust funds to the client account. This may well lead to safer, more efficient practices in respect of the client account.

There are other proposals set out below, for which DSBA has concerns in respect of the burden and cost of practical implementation without necessarily making the client account much safer.

While DSBA welcomes the proposed update to Solicitors Accounts Regulations, we are keen that the profession does not lose sight of the reason that such regulations are required – that is for the protection of client money and the Compensation Fund. Outside of urgent updates or terminology updates which will require immediate implementation, consideration could be given perhaps to more incremental change where each change is assessed for its effect on practice through a regulatory impact assessment and then, if required, regulation could be increased or tightened. It is easy to increase the burden of regulation but not so easy to reduce it. The profession must be vigilant against an increase in regulation becoming a barrier to entry or placing additional costs on practices without a corresponding evidence-based increase in safety of client money.

**5.0 Concerns:**

DSBA welcomes many of the proposed changes in the new SARs. There are a number of changes however which cause us some concern in respect of their practical application. There may be an increase in regulatory burden without a corresponding increase in safety of client money.

**5.1** *Proposed Regulation 38- Maintenance of Records*

*38        A solicitor shall maintain and keep the following records:-*

*(1)   an up-to-date register of all client files to show the date file opened, date closed and the archiving thereof;*

*(2)   a register of undertakings to disclose the date the undertaking was given, the identity of the client in respect of which the undertaking was given, the identity of legal entity in receipt of the undertaking and the date the undertaking was complied with;*

*(3)       a register of all deeds held by him/her for stamping showing the effective date on which the deed was due for stamping, the date the deed was stamped and the amount of duty paid;*

Most solicitors will have such registers in place in order to comply with the requirements of their insurers. Holding such registers is also a matter of good practice.

This is a new regulation concerning the maintenance of records by solicitors. This was not previously covered in any other iteration of SARs.

The principle of professional secrecy or solicitor/client privilege is one that is protected by the Constitution and a cornerstone of the legal profession. It is in many ways what separates us from other professions. The function of SARs being to protect client money, it is difficult to see how the Society having access to such records affords more protection to client money but it will certainly involve a compromise on our client’s privacy without perhaps making their money any safer.

In respect of an undertakings register, it is difficult to see how Law Society access and inspection of same will prevent loss to client money. The jurisdiction in respect of non-compliance with undertakings is currently held by the High Court and the LSRA. Further regulation in respect of undertakings by the Law Society would appear to be a duplication of effort and unnecessary. Many undertakings are given in the course of business which do not concern client money and even where undertakings do concern client money there is already in place a robust system for enforcement.

The failure of a solicitor to stamp a deed will incur penalty from the Revenue Commissioners and where a mortgage is taken by the client, possible enforcement action for breach of undertaking to the bank. In times past, when stamp duty was up to 9% of the value of the property perhaps such matters were more contentious. The vast majority of transactions now in respect of stamp duty concern residential property with a rate of 1% applicable which change must have increased the level of compliance. In any event late stamping of deeds would concern negligence (in the vast majority of cases) and not fraud meaning that it is a matter for the solicitors’ insurers and not the Law Society’s Compensation Fund. Separately, a review of the decisions of the Solicitors Disciplinary Tribunal for the past 5 years have shown that no solicitor has faced a sanction for failure to stamp deeds on time or “updating” deeds.

The Institute of Chartered Accountants in Ireland has not yet published its work statement or method in respect of auditing solicitors accounts pursuant to the new SARs. This is quite understandable given that the SARs are not yet finalised but it will be interesting to see how this element of our audit will be dealt with. It will certainly not make our audits cheaper and may add significantly to the costs.

**5.2** *Proposed Regulation 13(7)*

*Without prejudice to the generality of Regulation 13(1), a solicitor shall record in his or her books of account each of his or her transactions on office account with moneys (other than clients' moneys or moneys referred to in Regulation 13(2)(a) and other than controlled trust moneys or non-controlled trust moneys and other than insolvency arrangement moneys) as appropriate, in the following books of account:*

*(a)*     *a record of office receipts and payments;*

and

*Proposed Regulation 25(1)(h)*

*a copy of each document or record issued by the bank in respect of electronic transfers of funds on a file dedicated for that purpose. Where moneys are withdrawn from a client account by means of an electronic funds transfer from the client account, the solicitor shall retain on the client’s file, and a copy on a separate file dedicated to recording such transactions, the document of record issued by the solicitor and such other documentation issued by the bank to confirm that the transaction has been completed in accordance with the instructions of the solicitor Where moneys are received by electronic funds transfer into the client account, the solicitor shall also retain on the client file a copy of the document of record issued by the bank to confirm that such transaction has taken place.*

Currently the audit has regard to copies of the Office Bank Statements, the Office Account Bank Reconciliations, a list of office payments and receipts. It is not necessary to keep records to the same extent as the client account, e.g., it is not necessary to keep returned paid cheques and the office accounts do not need to be audited.  The monitoring of the office account is generally concerned with payments out of the office on behalf of the client [outlay] and then the repayment of that outlay from the client account [where appropriate]. The new SARs drag a much greater level of detail about the office account into their remit and consequently, if this regulation along with others is implemented, open the practice to further review and regulation by the Law Society. It is unclear how more access to detail on the office account will keep client money safer.

Our work as regulated professionals and our commitment to the rule of law, as solicitors means that we compromise our personal privacy in order to carry out our work. We accept this as part of acting as a legal practitioner. That said, this regulation will not only open how much we pay in, say, taxes or pension contributions [or indeed to whom] but will also open up the wages paid to staff, the rent paid on leases and much other commercially sensitive information to scrutiny. In addition, it will be necessary to keep a copy of all EFTs on the office account. From enquiries made with the Law Society, we understand that when this proposed regulation is implemented it will cover all EFTs on the office account, not just those concerning outlay. This will mean disclosing the bank account details and personal information of our staff and creditors to our auditors and the Law Society, in what must surely be a GDPR nightmare.

In addition to the GDPR and privacy concerns, the DSBA is also concerned on the burden that this will place on practitioners. Even the most modest of practices would have thousands of transactions on the office account, meaning that a far more onerous level of record-keeping and scrutiny will be required on the implementation of such regulation. The cost of testing this regulation must also be borne in mind given that our auditors will no doubt have to certify our level of compliance.

It is difficult to see objectively how the implementation of this regulation will lead to safer client money whereas it is certain to result in more time and compliance costs. This can be illustrated in a practical way. Many larger solicitors’ firms will use a limited liability company to service their office requirements, but this company will effectively have the same shareholders as firm owners and carry out the same tasks as an office account in a smaller firm. However, these service companies will not be subject to any scrutiny by the Law Society notwithstanding the foregoing considerations. DSBA is of the view that if there is no objective requirement to scrutinise the transactions carried out by such service companies, there ought be no requirement to scrutinise such transaction on an office account. For the avoidance of doubt, DSBA is entirely supportive of the requirement for record keeping in respect of any outlay [the client side of the office account].

**5.3** *Proposed Regulation 13(10)*

*(10) It shall be a breach of these Regulations for a solicitor to withdraw moneys from the client account without reference to an up-to-date client ledger account.*

For DSBA, a counsel of perfection would be to have all transactions on the client account written up on a real-time basis, as if practitioners operated a bank. It would certainly go a long way to prevent any errors and focus the mind of solicitors before making a debit on the client account to ensure that there is a corresponding credit on the ledger. There are however some practical considerations to be taken into account when looking at the effect on practices of such a regulation. If any level of conveyancing or probate is carried out by a practice, it will mean that the clients may suffer additional delays in the course of their transactions or alternatively that a book-keeper will need to be engaged to update the records of the practice on a daily basis. Clients are unlikely to put up with delays to a transaction or wait for their money. To keep money for longer than necessary will be costly for both solicitor and client (in terms of bank interest charges). In order to effect compliance therefore, the practitioner will be obliged to write up the records of the practice every day with all the costs and time commitments which will flow with such a requirement.

Currently, solicitors have a practice of dealing with property transactions by reference to EFT printouts of incoming funds and a closing account. In this way, until the ledgers are written up, the money is tracked coming in and going out.

There is no doubt as to the effect on the safety of such a measure but its practical effect including the costs of such implementation are of real concern to the viability of practices.

**5.4** *Proposed Regulation 25 (1) (a)*

*a record of receipts and payments, which separately records transactions on office account, on client account and, where applicable, for transactions on controlled trust account or on non-controlled trust account or on insolvency arrangement account (herein after referred to as "each account") including details of the identity of the source of the moneys received and the identity of the recipient of the moneys paid;*

Some of the work that solicitors undertake is subject to AML legislation and therefore the solicitors engaged in this work must capture a lot of detail about the client identity and source of funds.

Some forms of work of solicitors are not captured by AML legislation [e.g. litigation, matrimonial matters] and accordingly, such detail about identity and source of funds is not required. That said, many practices in the modern age will have standard client on-boarding processes and capture this type of information even where the work is not covered by AML legislation.

DSBA is concerned that the above proposed legislation will lead to the creation of an unnecessary burden on solicitors without a corresponding increase in safety for client money. From enquiries made DSBA understands that the detail required in respect of the identity of the source of money lodged is confined to recording the identity of the party who provided the money to the solicitor. If this is how the regulation is interpreted in practice, it may well be difficult for the solicitor to show compliance with this regulation. By way of illustration, many solicitors now issue an invoice with their bank account details printed thereon inviting the client to discharge the invoice via EFT. Where the party lodging the funds is a natural person, they are unlikely to send on a remittance advice with the funds but may simply include the file reference. The solicitor may not therefore have the ability to identify the party lodging the funds to the account and instead, will have to rely on how it shows up in the bank statement [a matter not within the solicitor’s control]. The net effect of demonstrating compliance with this regulation may be confined to printing each individual lodgement notification on the bank account (and this is not always possible) which will provide insufficient detail to comply with the regulations and is a very onerous paper exercise. If the notification does not show the detail will the solicitor then be non-compliant?

**6.0 Alternatives and additions**

The level of detail, oversight, compliance and audit required should the proposed Regulations be passed as they are currently drafted will drive up the time involved and the cost of compliance for practices.

There has been a significant ramping up of regulation in the past few years and the effect of even more regulation may well be a barrier to entry or push some smaller practices into a decision to shut down. This may in turn cause an access to justice issue for those clients who rely on sole practitioners and small practices. This is why the DSBA believes that it is important to have sight of the Regulatory Impact Assessment in advance of the commencement of the SARs.

Indeed the introduction of the proposed SARs may have the effect of an increased workload on not just practitioners and their auditing accountants but for those in the Law Society Regulation Department who audit practices.

Many of the changes outlined in the proposed SARs are similar to what was previously introduced by the SRA in England and Wales in the early part of the last decade. Anecdotally, DSBA understands that this change in regulations led to an increase in the number of staff required in the SRA in order to deal with such regulation.

 **6.1 Third Party Managed Accounts**
That said, in 2017 the SRA introduced a way for practices to avoid holding a client account with all the attendant risk and costs and heavy regulation. For the past 5 years, solicitors can use a Third Party Managed Account [TPMA] in place of a client account (as they wish).

A TPMA is effectively a fintech solution for practitioners and acts as an alternative to holding a client account. There is no obligation for a solicitor to hold a TPMA, if they do not wish to, they can continue to hold a client account.

How it works is as follows. The practitioner enters into a contract with a TPMA provider [who are themselves regulated by the Financial Conduct Authority] and notifies the SRA that they will not hold a client account. From then on, the practitioner must not hold client money. The practitioner informs their client that they do not hold client money and that they have a contract with a TPMA provider. This is usually disclosed as part of the standard Terms and Conditions sent to their client. The solicitor then enters their client contact information on the TPMA platform. They can at the same time enter any information regarding the other party to the transaction, e.g., the Purchaser’s solicitors’ information. The TPMA provider then contacts the client and captures the information and documentation required for AML compliance. Thereafter any funds to be transferred as part of the client matter will be sent to the TPMA provider. The solicitor will not hold funds but will authorise their release in due course. One facility offered by TPMA providers in the UK is to permit the client to access their own ledger which must be both convenient and transparent.

The benefits of holding a TPMA pursuant to the SRA regulations include the following:

* No requirement to hold a client account
* No obligation to prepare audited accounts
* No need to submit an accountant’s annual report
* No contribution to be made to the Compensation Fund
* No client account practice inspections/audits by SRA
* Worry about the cyber-attack on client funds/stealing by solicitors or staff member eliminated
* AML responsibilities shared with the TPMA provider.

Naturally, there are some disadvantages to holding a TPMA – it may slow down client on-boarding; there are charges associated with the use of a TPMA [a subscription fee and then a fee per transaction]. Transactions may take a little longer to process given that the funds first have to be lodged to the TPMA account. That said, the adoption of a regulation by the Law Society permitting TPMA would give practices a choice about how they manage client money and perhaps prevent client account regulation becoming a barrier to entry.

The TPMA would fit into the new e-conveyancing model proposed by the Law Society nearly seamlessly in that it would deal with the transfer of funds and their safety while security is being put in place, say in the case of a mortgage.

**6.2 Solicitors Benevolent Association**

Proposed regulation 13.8 provides that

*the total of the credit balances due to his or her clients as extracted from the client ledger accounts, analysed as between balances outstanding for a period of less than two years and balances outstanding for a period of two years or more,  including credit balances in respect of controlled trust moneys or non-controlled trust moneys held in client account, controlled trust ledger accounts, and insolvency arrangement ledger accounts, provided that, without prejudice to the generality of Regulations 7(2)(a), 18(5)(a) and 23(4)(a), the solicitor shall not offset debit balances against credit balances, other than a debit balance or balances arising on one or more ledger account or accounts which is or are totally offset by a credit balance or balances on one or more other ledger account or accounts in respect of, as the case may be, the same client within the client ledger, the same controlled trust or the same insolvency arrangement;*

**AND**

*A solicitor shall list client ledger balances outstanding two years or more as at the accounting date, disclosing the reason the balance is outstanding and action taken or proposed to clear the balances, such list to be approved by the compliance partner, and the information therein shall in turn be provided to the Society in the form of and as Appendix 6 to the reporting accountants report for the accounting period in question.*

This regulation introduces a requirement of solicitors that they account for any balances older than two years and also that the solicitors report the reason for such balance at the end of that time. This is an onerous regulation in that there are many perfectly valid everyday reasons why it might be necessary to keep funds on account for some years.

Separately, there may be small balance on the ledger and in the client account where the client has moved on without giving a new address or where funds were held on account and that person, despite the solicitor’s best efforts is untraced or where for example the funds were belonged to a corporation which has since dissolved.

The equivalent of the Solicitors Benevolent Association in England and Wales is known as “The Solicitors Charity”. Subject to SRA regulations, funds can be transferred to the Charity on the basis of a full indemnity – that is that if the client ever arrives to claim the money the Solicitors Charity will immediately arrange to repay the solicitor who can in turn pay the client. This is an innovation proposed some time ago by the Solicitors Benevolent Association and must be a worthwhile consideration in that this would have the effect of assisting solicitors in compliance with the regulations as well as assisting a very worthwhile cause.

 **7.0 CONCLUSION**

DSBA supports compliant solicitors. As US Deputy Attorney General Paul McNulty said *“If you think compliance is expensive – try non-compliance”.* Client money, the compensation fund and the reputation of solicitors are matters which require constant vigilance. The existing regulations and oversight of the Law Society have proved effective in the safeguarding of client money.

Over-regulation can lead to less competition and can form a barrier to entry to a profession. By careful analysis through a regulatory impact assessment, the best way forward can be found for the regulations which will ensure a balance between keeping money safe and allowing practitioners to get on with their business which is ultimately serving their clients.

An effective alternative to client accounts has been provided in England & Wales through Third Party Managed Accounts which mean that those solicitors who wish to can avoid holding client money can do so. Those who wish to continue holding client money can also do so subject to regulation by the SRA.

DSBA commends the Law Society for engaging with the Bar Associations and members and encourages the Law Society to consider further the proposed regulations and to provide an education and communication programme before they are implemented.