How other regulators and jurisdictions hold client money

Research to inform the SRA's Consumer Protection Review

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1 Executive Summary

This independent research aims to consider the following questions:

- How do other regulators and professions handle client money?
- What are the rules around client money?
- What are the levels of consumer protection?
- How do the rules make it easy for practitioners to do business? How is transparency ensured?
- Are there any models or aspects of any alternative models to the current system that the SRA could consider?

The alternative models that have been identified in this research can be broadly organised into two categories.

1. **Third party solutions** for handling client money including:

- escrow providers
- Third Party Managed Account (TPMA) providers
- trust accounts managed by financial institutions
- alternative banking solutions (virtual accounts)
- portals or platforms for managing client money where the regulator may also have access to information (Canada).

Current legal practice management and cashiering software providers may also have an opportunity to enter this category.

2. **Reduced or no client money handling** where law firms are not permitted to hold client money (eg France, and an option for conveyancing money in Singapore). With these models, law firms are not required to contribute to compensation funds as there is very limited risk of client money being mis-handled. Similarly there is the potential for reduced costs of professional indemnity insurance (PII)[1] given the reduced risk. Although it is rare for jurisdictions to exempt a law firm from some level of PII, in Canada and Australia some smaller law firms can seek to reduce their PII coverage (and therefore cost) if they do not hold client money.

The research has not to date identified any easily applicable models that could be lifted wholesale from other jurisdictions or professions and applied to the legal sector in England and Wales. However, there are several areas worth exploring further that may work in isolation or in combination. When evaluating whether the models are worth exploring further by the SRA, the criteria were: is it sufficiently different to SRA rules? Has this model got 'traction' elsewhere, is it tried and tested – for example number of users, amount of money handled, number of transactions? Are there significant (and measurable) consumer/law firm benefits?

Research has identified several elements of alternative solutions where technology is being used to improve client money handling processes. These could help to meet the SRA's aims of improving the protection of client money by increasing transparency; reducing the risk of misappropriation or misallocation of client money; improving governance and traceability of transactions; and improving efficiency. From the broader review of various jurisdictions, professions and providers in Appendices 1–3, five models have been selected to cover in more detail:

- CARPA in France, see **4.2.1**
- Client Accounting Service Providers (CASPs) and Client Money Protection (CMP) insurance in the UK property sector see **4.2.2**
- Royal Institution of Chartered Surveyors (RICS) approach of Third-Party Transaction Service Providers (TPTSPs) in the UK see **4.2.3**
- My Trust Account (Canada Revenue Agency) see **4.2.4**
- PEXA conveyancing platform in Australia see **4.2.5.**

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1 Although, according to Miller Insurance's response to the SRA consumer protection review discussion paper: "*Having had discussions with several established insurers on this matter, they suggest that the impact of implementing Third Party Managed Accounts (TPMA) across the profession would have minimal impact on their risk considerations and possibly the overall claims (by number or value). Therefore, such a change would have no immediate impact on the insurance premiums charged*." Thoughts on the SRA's Protecting the public: our consumer protection review

In addition to examining the offerings of TPMA providers and escrow paying agents, offerings have been explored from:

- virtual account and Bank-as-a-Service (BaaS) providers
- payment and settlement platforms and exchanges
- vendor offerings both in the legal sector and those focused on anti-money laundering (AML)/anti-fraud solutions.

Data are not available (in the public domain) for exactly how the value and volume of client money held and moved differs across the profession but it could be useful to understand in more detail. With these data it could be possible for the SRA to take a sector-based approach, applying different client money handling rules to different situations based on the risk involved, whether that is size of firm, type of firm, practice area of the firm and/or transaction type.

2 Introduction

The SRA outlined that its Consumer Protection Review will look at what can be done to reduce the risks that consumers suffer harm in the first place. This includes if there should be changes to SRA rules around firms holding client money. As part of the Review, the SRA has commissioned this research to explore different approaches to managing the risks of holding client money. The SRA seeks to understand more about arrangements for client money used by other regulators and similar organisations, sectors and/or jurisdictions including the high-level benefits and disadvantages of those options for consumers and practitioners.

This research, whilst necessarily limited in scope, seeks to identify alternatives to client money handling and to evaluate the benefits and disadvantages of these models (to consumers, law firms and the SRA) and any other factors to consider.

Using alternative approaches to handling client money may mean that regulation can be reduced for the profession, lowering the overall cost of regulation and potentially delivering cost savings for law firms that can be passed on to consumers.

3 Methodology

Desk research was conducted by a team of three researchers experienced in the legal and financial sectors, informed by existing SRA internal documents around policy and handling client money and a review of available literature. Some of the relevant institutions, escrow finance providers, tech vendors, industry associations and/or regulators were also contacted directly to fact check and to bring additional context to the findings. There are separate appendices with findings for the following (see Appendices 1 to 3):

A1: Research into the regulation of client money handling in other jurisdictions:

- Common law jurisdictions[2]: Australia, Canada and New Zealand
- Civil and/or mixed legal systems: France, Singapore and the UAE

A2: Client money handling in UK financial services sector and other professions:

- Financial services: insurance intermediaries and investment managers
- Professions: accounting, architecture, property management and agency, surveyors

A3: Identification and review of third-party providers in this space or adjacent (illustrative not exhaustive, and inclusion in this report is not an endorsement or recommendation for any provider[3])

- Third Party Managed Account (TPMA) providers: ShieldPay, dospay
- Bank integrated payment systems and reconciliation platforms: Payprop, AccessPay
- Virtual account providers: Cashfac, Barclays, Starling[2], Tietovry (Nordic)
- Escrow/paying agents: LawDebenture, Shieldpay, dospay, Transpact, Cashfac

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2 Common law systems have a body of law based on court decisions (Australia, Canada, New Zealand) rather than civil law or mixed jurisdictional systems which are based on codes or statutes (France, Singapore, UAE).

3 Providers within each category were identified via desk-based research and are included as examples of different provider types. Within each category there are likely to be other major players that have not been included in this research.

* At the time of publication, some control failings at Starling banks had been reported: https://www.fca.org.uk/news/press-releases/fca-fines-starling-bank-failings-financial-crime-systems-and-controls

- Settlement exchange and digital fund management systems: PEXA, SureFund (Canada)
- Bank-as-a-Service (BaaS): Griffin, Starling, ABN Amro
- Blockchain and real-time settlements: Coadjute, Project Meridian
- Onboarding/know your client (KYC)/ anti-money laundering (AML)/anti-fraud vendors: Thirdfort, Verify 365
- Legal sector practice management /accounting software: Quill, Clio, Cashroom, LawWare

Within each area of interest, the research aimed to identify reliable, accurate and up-to-date sources.

- Primary sources: statutes, regulations and rules. These were accessed through regulators' own websites and relevant professional bodies and institutions (primarily English language).
- Interviews conducted with Shieldpay and Council for Licensed Conveyancers to assist with initial scope.
- Secondary sources: included interpretations, analyses, and commentaries on the rules and guidance, including legal journals, law reviews, blog posts, technology providers' own websites and other sources of professional commentary and guidance including handbooks4.
- Out of scope: client account rules textbooks[5], practice guides and commentary.

4 Research Findings

4.1 How do other regulators and professions handle client money? What are the rules?

In terms of client money, the common law jurisdictions[2] that were researched had fairly similar rules and regulations to the approach in England and Wales governed by the SRA and the Financial Conduct Authority (FCA). In many legal jurisdictions there is also some considerable overlap with the regulation and practices around money laundering and prevention of financial crime. There were some similarities in the approaches adopted by the various professions. When looking at the rules and definitions around client money and how that is managed, consistent principles across the jurisdictions and sectors include:

- requirement to segregate client money from other funds and to have written assurance from banking providers that the client money will not be offset against any unauthorised debts incurred by the provider
- need to hold client money in separate designated client accounts at authorised institutions or an approved finance company under a financial regulator (for example in Australia one of the regulators approves a list of Authorised Deposit-taking Institutions (ADIs))
- pooled client accounts are common practice, though if the balance exceeds a certain threshold there may be the requirement to have an account specific to the client
- obligations around reconciliation, reporting, record-keeping, and prompt moving of money (client account is not a banking facility)
- some type of annual audit whether this is submitting documents to a regulator and/or conducting a third-party external audit using an accountant or examiner
- obligations around client consent and access to the funds (the terms under which the money will be held)
- rules on how payments are authorised and managed by the firm and with the client and/or third parties, management of withdrawals
- supporting elements to protect against loss and/or fraud, either preventative (cyber security) or compensatory such as professional indemnity insurance (PII), separate bond or insurance policy and/or a compensation fund such as the Client Money Protection (CMP) scheme in the property sector.

Definitions of client money across the jurisdictions are conceptually consistent although the terminology varies (for example trust money, trust accounts or controlled money) and there is not a single accepted definition of client money across areas outside legal services. Typically, client money is defined as currency, assets or funds wholly owned by the client that is entrusted to a law practice and directly related to legal services.

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4 For example, The Law Society of New South Wales: Legal Accounting Handbook.
5 For example, LexisNexis Australia: Client Money: Trust Account Management for Australian Lawyers.

Examples of types of client money in the legal sector include:

- Client damages or settlement money received by a firm through litigation
- Mortgage, probate or other transaction money received from a lender or third party on behalf of the client
- Money for a firm's fees that are received on account
- Money intended for specific costs associated with a client's matter eg court fees, barrister fees, surveyor costs or other professional disbursements
- Funds held in trust for clients (wills, estates).

Once funds are determined as 'client money' or equivalent, they must be managed according to specific central or state/provincial regulations. There are some differences in jurisdictions when client money can be pooled, co-mingled or must be held separately:

- For barristers in England and Wales, a fixed fee paid in advance is not classed as client money[6] and in any event, barristers are not permitted to hold client money although they may use a third-party payment service if it meets with the Bar Standards Board's (BSB's) approval.
- Costs lawyers cannot receive client money either, unless they are working in a firm authorised by the SRA or using a TPMA, so professional fees are excluded from the definition of client money by the Costs Lawyer Standards Board (CLSB)[7].
- Under the CILEx Regulation Accounts Rules[8], practitioners must pay client money into a Client Account. Withdrawals must be made according to clients' authority, records must be kept and retained and practitioners must deliver to the regulator an Accountant's Report every year.

Not all professions regard advanced payment for services as client money. Examples of client money outside of the legal sector include:

- Property: rental deposits, funds for property works, funds for reference checks.
- Insurance: insurance premiums collected by brokers to be paid to the underwriters.
- Investment: funds for investments paid to investment managers.
- Accountancy: collecting tax rebates for clients, paying wages to staff for clients, handling Construction Industry Scheme (CIS) subscriptions.

4.2 Professional models

The research investigated client money handling procedures in the financial services sector, namely insurance brokers and investment managers, and in professions including accountancy, architecture, property management and surveying.

The client money handling requirements for the financial services sector, as detailed in the Client Asset Sourcebook (CASS) were not considered by the researchers to be proportionate for law firms. The rules in place for insurance brokers and investment managers are highly complex, given that holding client money is intrinsic to the nature of the business conducted and the risk profile of the sector. The volume and value of transactions are much higher than in the legal sector and any breaches would be considered a systemic issue for the sector as a whole. As such, the approaches taken towards client money were considered disproportionate to the needs of law firms, which are not handling comparable volumes of client money as the primary function of their business nor holding client money over the longer-term.

The financial services sector also operates the Financial Services Compensation Scheme (FSCS), which reimburses consumers holding certain regulated products when firms fail. This can include funds lost to fraud, where the firm cannot meet those obligations directly and ceases to operate. The FSCS does not improve client money handling processes directly but acts as safety net to protect customers of authorised firms. The client money requirements for accountants and architects are broadly similar to the current approach used by law firms and the research did not find any materially different models to investigate. However, the property sector offered examples of three models, which could be investigated further for use, potentially with some adaptation, for the legal sector. See paras **4.2.2, 4.2.3** and **4.2.5**.

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6 Part 6: Definitions - BSB Handbook
7 Scenario: You're asked to handle your client's money – CLSB
8 https://cilexregulation.org.uk/wp-content/uploads/2018/11/CILEx-Accounts-Rules.pdf

Property sector

Within the property sector there are several initiatives and technology driven offerings that could transform the nature of client money management in future.

- **PayProp**'s automated rental payment platform for letting agents **aims to significantly reduce the length of time that money is held** in a client account related to these transaction types (payment of rent, payments to landlords, contractors etc). In addition to reducing administrative burdens and the risks of holding client money, there is likely to be an insurance cost benefit, given that most CMP providers base the cost partly on the highest amount of money a letting agency has sitting in their client account throughout the year[9].
- **Project Meridian** - was a project run jointly between the Bank of England and the Bank for International Settlements' London innovation hub to build a digital settlement prototype that speeds up payments in conveyancing by linking banks, conveyancers and HM Land Registry (completed in April 2023). To reduce the possibility of payment failure, the project used Bank of England money in a Real-Time Gross Settlement (RTGS) system, using distributed ledger technology, to switch assets at an agreed time. Rather than deposit funds being sent to the conveyancer's client account and mortgage funds disbursed, cash funds were put on hold at source[10].
- **PEXA Pay**, a payment system developed by the UK-based arm of **PEXA Group, is** dedicated to property settlement. PEXA Pay leverages the Bank of England's RTGS system to settle residential and buy to let remortgage transactions, and will be extended to cover sale and purchase transactions in the future[11]. PEXA UK is regulated by the Council for Licenced Conveyancers.
- **PEXA** Australia, also part of PEXA Group, is an electronic conveyancing platform which digitises the process of property settlement, aiming to make it more efficient and secure. PEXA is regulated by the Registrar in each Australian state where it is active and according to investor data, handles transactions for 22,000 properties a week and has 89% penetration in the Australian Exchange[12]. The PEXA source account is maintained by PEXA with an Authorised Deposit Institution (ADI) regulated by the banking regulator.
- The introduction of enhanced data requirements for **CHAPS** payments (the high-value payment system operated by the Bank of England) means that from May 2025 all property-related transactions will need to include purpose codes (from a predefined list). This is part of a wider initiative to improve payment transparency and combat financial crime[13].

Third party managed solutions

Property agents and managers can outsource client money management and accounting with registered companies known as Client Accounting Service Providers (CASPs). CASPs are regulated by Propertymark and collect money in line with regulatory requirements, conduct reconciliations and make payments. Firms regulated by the Royal Institution of Chartered Surveyors (RICS) (in property and surveying) can use Third-Party Transaction Service Providers (TPTSPs) to process client money. The RICS-regulated firm authorises the TPTSP to control the client account on its behalf and outsources accounting, documentation and the movement of money. Desk research has not revealed any companies that describe themselves as TPTSPs at this stage, but companies that operate under the CASP model above could fulfil this function.

There are some similar models to TPMAs introduced in other jurisdictions. New Zealand provides some guidance on outsourcing client money to third parties in that the outsource provider needs to identify with the FSPR but there is limited evidence so far that these types of providers are being used by law firms. Canadian lawyers and bookkeepers can use My Trust Account which is a service for secure online management of trust information provided by the Canadian Revenue Agency (see **4.2.4**). In Singapore, TPMAs have been introduced for conveyancing which removes the solicitor from the handling of money as set out in the Conveyancing and Law of Property Rules 2011, making it an offence for solicitors to hold conveyancing money or anticipatory conveyancing money except in an escrow agreement or Central Provident Fund (CPF) account[14]. PEXA, the electronic conveyancing platform in Australia is covered in more detail at **4.2.5** below.

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9 How PayProp can help with CMP insurance | Propertymark

10 All-digital trial sounds death knell for paper-based conveyancing - Legal Futures

11 All-digital trial sounds death knell for paper-based conveyancing - Legal Futures

12 https://www.pexa-group.com/staticly-media/2024/08/Investor-Presentation-vF-sm-1724195453.pdf

13 Additional Guidance: Detail on Mandating ISO 20022 Enhanced Data in CHAPS.

14 CPF is a compulsory savings and pension plan for working Singaporeans and permanent residents to fund retirement, healthcare and housing, much like the National Insurance and State Pension schemes in the UK.

The next section considers the five models identified in the research in more depth, see Appendix 1 for more detail on CARPA.

4.2.1 *CARPA (France)*

Model - broad description including mechanics, exclusions/limits

- It is mandatory for French lawyers to pay client money into a CARPA, a centralised system under dual oversight of bar associations and Tracfin (Financial Intelligence Unit). The CARPA initiates transactions and provides reporting and reconciliation. In 2020 there were 122 CARPAs in France handling 8,500 transactions daily.
- Lawyers who handle client funds in connection with their legal practice have an obligation to deposit funds into CARPA, including clients who have made advance payments for fees. It is a disciplinary offence not to hand over client money to CARPA, this is enforced by the relevant bar association.
- Law firm employees are trained to use the system as they need to understand how it works, but it is relatively straightforward and the training is delivered by the Bar team in charge of CARPA.

Benefits (consumers, firms and regulator)

- Compliance with GDPR, money laundering regulations and risk management surrounding politically-exposed persons (PEPs) and counter-terrorist financing are assured.
- Reduced risk of fraud or loss by the profession as all funds are held centrally and securely and the source and destination of the funds is tightly controlled.
- For law firms, CARPA streamlines financial management and reduces cost of administering funds in-house.
- The interest allows the Bar Association to make investments or (as was the case this year in Paris) to lower the bar fees for lawyers and to finance legal aid.

Disadvantages (consumers, firms and regulator)

- The speed of transactions can vary due to complexity, documentation required and the internal procedures of the specific bar association managing the CARPA.
- As the purpose of the system is to generate interest, it is required that the funds are invested for a few days or weeks.
- Centralising client funds, even at bar association level, increases the risk of being a target for hackers seeking access to funds and personal data.
- It is possible that users may encounter service disruptions or performance issues. Whilst any financial management system can experience technical issues, any downtime or outages have not been identified relating to CARPA.
- Some firms pass on the administrative costs of using CARPA to clients.
- Harder for law firms to manage cash flow and firms/clients do not receive the benefit of interest on their funds.
- CARPA may face challenges in efficiently managing transactions involving international clients and cross-border deals and may not hedge effectively against fluctuations in exchange rates.

Factors to be considered by the SRA were it to explore this model further

- Added expense of establishing a centralised system, run centrally or by each local law society, and in driving cultural change for law firms to adopt a new way of working.
- Cost of compliance - the system needs to be set up in such a way that it is completely secure, easy to use, efficient, safe and immediate. Likely to incur significant initial investment as well as ongoing operational cost.
- Firms would not be receiving interest therefore a centralised system may be less commercially beneficial unless savings are delivered in cost of compliance, insurance or reduced compensation fund payments.
- Unlikely to be suitable for the complexity and value of transactions in the UK legal sector especially magic circle, commercial and cross-border transactions including multiple currencies, stakeholders and exchange rates.
- The French regulatory framework does not currently specify a minimum service level for speed of transactions of CARPA, but a regulator could put a speed/delivery of funds requirement in place.

Any impact on firms and consumer access to justice of this model

- Whilst a full-sector CARPA model may not be feasible, small firms or sole practitioners may benefit from a central or other more secure way to manage client funds.
- Regulators would be able to monitor and identify misconduct more easily and compliance would be built-in to the system.
- Education and communication would be essential to ensure that clients and law firms understand the benefits and new ways of working.

4.2.2 Client Accounting Service Providers (CASPs) and Client Money Protection (CMP) Insurance in the UK property sector

Model - broad description including mechanics, exclusions/limits

- Property agents and managers have the option of outsourcing client money handling to third parties referred to as Client Accounting Services Providers (CASPs)[3]. CASPs must be regulated by Propertymark or RICS[4].
- CASPs can manage all aspects of client money handling, including account opening, collection, processing, reconciliation and payments. Depending on the provider used, CASPs can open a designated client account with their own bank or access the property company's client bank with permission.
- Property agents and managers are not obliged to use a CASP and can manage client money in-house. However, they are legally required to belong to a registered Client Money Protection (CMP) scheme that reimburses client money in the event of misappropriation of client funds, although cover levels vary between the different approved CMP schemes. Agents typically pay an annual levy to belong to a CMP, with the levy determined by the total value of client funds held. Most CMP schemes require members to submit an annual accountant's report that checks if the company is following client money handling requirements. If using a named CASP, that is stated clearly in terms of business and tenancy agreements, the accountant's report requirement is normally waived as the liability falls on the CASP.
- The CMP does not remove the need for property managers and agents to also hold PII.
- Examples of CASPs include Abode Accounting, The Letting Partnership and RatioBox Lettings.

Benefits (consumers, firms and regulator)

- Alleviates the administrative burden, both in terms of managing client money on an ongoing basis and meeting regulator or member body compliance requirements. They are particularly useful for smaller organisations, with less bandwidth for managing accounts.
- Overcomes the challenge that some property agents are facing in opening/holding pooled client accounts. Some institutions are refusing or closing these accounts due to concerns of falling foul of anti-money laundering requirements.
- Reduces the risk of fraud and misappropriation of funds. Money is paid straight to the client account run by the CASP, rather than transferred from the agency account to the client account run by the agency.
- Consumers have clear information on the CASP used and have greater transparency on their funds - depending on the CASP used and the information provided to the customer.
- Agencies can monitor and view account transactions, but do not manage the account or funds directly thereby reducing the risk of mis-use.

Disadvantages (consumers, firms and regulator)

- The agency has to bear the administrative burden of updating tenancy agreements and all paperwork detailing the CASP used. Although in the long-term, they will have a reduced administrative workload through using a CASP.
- The agency might only be able to view account activity but might not be able to manage the account activities.

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3 Propertymark, Accountant's Report
4 Propertymark, Accountant's Report

- Consumers may be uncertain about an unknown third party holding their money. However, that CASPs are regulated should provide some reassurance.

Factors to be considered by the SRA were it to explore this model further

- What regulatory framework the SRA would put in place for a firm to be a CASP? Would the SRA directly authorise CASPs and the regulatory requirements they would have to meet? Or authorise the use of regulated CASPs from the property sector?
- Whether CASPs would be able to access the firm's client account or would be required to hold the account.
- Regulatory ability to identify misconduct more readily.
- If mandating the use of CASPs, there is the question of whether CASPs or the regulator would maintain any compensation fund or hold insurance policies given the liability would fall with them rather than the law firm in the event of misuse of funds.
- How consumers would be informed and made aware of third-party providers, so that consumers know how the system works and that they are using a regulated provider.
- How law firms would be enabled to adopt and implement the CASP model (education, knowledge and support).

Any impact on firms and consumer access to justice of this model

- Education and communication would be essential to ensure that consumers understand the process and to ensure they are using a regulated provider, and that law firms understand how to implement this model effectively and amend working practices as needed.

4.2.3 RICS - Third Party Transaction Service Providers (TPTSPs) in the UK5

Model - broad description including mechanics, exclusions/limits

- RICS-regulated firms have the option of using a TPTSP to manage client money. RICS defines a TPTSP as a company entirely unconnected with the regulated firm that provides payment processing services.
- TPTSPs can collect client money, hold it in their accounts, manage reconciliations and payments. They are not regulated, but in its March 2024 guidance on the use of TPTSPs, RICS reminds firms of their obligation to meet RICS's client money standard and to ensure that the use of TPTSPs does not put them in breach. In particular, it highlights the importance of the firm retaining the ability to gain exclusive control of client money.
- Where TPTSPS are used, RICS firms are obliged to inform their clients and provide details as to exactly how the TPTSP operates. Firms must also ensure that TPTSPs hold insurance to cover the misappropriation of client funds.
- RICS members are not required to use a third-party, but its members must also belong to a registered Client Money Protection (CMP)[6] scheme that reimburses client money in the event of misappropriation of client funds. RICS also operates a CMP for surveyor and estate agency members.
- The CMP does not remove the need for property managers and agents to also hold PII.
- TPTSP is a term used by RICS, but no firms appear to use this terminology to describe themselves. One example of a TPTSP is PayProp, which is a property management and rental payment platform for letting agents (see para **4.2**).

Benefits (consumers, firms and regulator)

- Alleviates the administrative burden for firms, once set up, both in terms of managing client money on an ongoing basis and meeting regulatory or member body compliance requirements. They are particularly useful for smaller organisations with less bandwidth for managing accounts.
- As with CASPs, overcomes the challenge that some property agents are facing in opening/holding pooled client accounts. Some institutions are refusing or closing these accounts due to concerns of falling foul of AML requirements.
- Reduces the risk of fraud and misappropriation of funds. Money is paid straight to the client account.

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5 Guidance for UK RICS-regulated firms handling client money using third-party transaction service providers.
6 Protecting clients' money if you're a property agent.

- Consumers have clear information on the TPTSP used and may have greater transparency on their funds - depending on the TPTSP used and the information provided to the customer.

Disadvantages (consumers, firms and regulator)

- The liability does not shift from the firm to the TPTSP, as such the firm has to conduct due diligence to ensure that the use of the TPTSP will not put it in breach of any industry regulations.
- TPTSPs are not regulated by RICS, as such there will be less confidence in which providers to use.
- Consumers may be uncertain about an unknown third party holding their money, particularly if they are not regulated.

Factors to be considered by the SRA were it to explore this model further

- Whether firms would be permitted to work with unregulated TPTSPs and perform their own due diligence that ensure that expected standards are met. This model offers greater freedom in choice, but reduced consumer confidence.
- Whether a minimum set of standards would need to be established for law firms to meet when selecting and working with TPTSPs.
- Whether it would require the use of a compensation fund or require firms to hold an insurance policy to reimburse consumers in the event of misuse of funds.
- How consumers would be informed about third-party providers, so that consumers know how the system works and that they have confidence and trust in the TPTSP used.
- How law firms would be supported to work with TPTSPs, in terms of following standards and best practice.

Any impact on firms and consumer access to justice of this model

- Education and communication would be essential to ensure that consumers understand the process and to ensure they are using a regulated provider, and that law firms understand how to implement this model effectively and amend working practices as needed.
- TPTSPs are unregulated so would have a different risk profile to CASPs for example. Consumer recourse and/or protection would be reduced under this model.

4.2.4 My Trust Account, Canada Revenue Agency

Model – broad description including mechanics, exclusions/limits

My Trust Account in Canada is a secure service provided by the Canada Revenue Agency (CRA) which enables legal representatives, accountants, bookkeepers or someone with power of attorney to manage client money online with three levels of authorisation. Level 1 access can view balances and ownership. Level 2 access can also request remittance vouchers and submit documents. Level 3 can arrange direct deposits, make payments online and view and update contact details. Funds are not held in My Trust Account, rather it is an overlaid portal to enhance accessibility and transparency, to which the regulator has access.

Benefits (including to consumers, firms and regulator)

- The CRA keeps audit trails of all access to the trust account information and can make use of this information[7].
- Practitioners can reduce exposure to risk through the use of the secure online system.
- The CRA has increased visibility into trust accounts.
- The client also has the ability to authorise practitioners to access their account although it is not clear whether the client has access to information and can view transactions.
- Alleviates the administrative burden for firms, once set up, both in terms of managing client money on an ongoing basis and meeting regulatory or member body compliance requirements.

Disadvantages (including to consumers, firms and regulator)

- Consumers may need reassurance that their funds are secure and may be uncertain about a third party holding their money unless known that the service is provided by the regulator.

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7 My Trust Account Terms and Conditions - Canada.ca

Factors to be considered by the SRA were it to explore this model further

- This might be particularly useful for sole practitioners who handle client money. A simple and secure online platform or portal that connects with financial institutions that hold the funds could enable the SRA to have visibility of size and volume of transactions and identify risk proactively.
- It would not need to be a legally qualified practitioner, an authorised individual could use the system.
- Platform or portal could be provided by an existing provider such as a TPMA, bank and/or tech provider.

Any impact on firms and consumer access to justice of this model

- Costs of initial development and ongoing operation.
- Changes to processes, systems and culture could be disruptive in the short term.
- Access for clients and consumers would promote transparency and enable them to view progress of their funds.
- Firms would need guidance on how to use the online system and may require a change to working practices.
- Must not exclude consumers who do not have access to digital services – a smartphone app could assist but would not be sufficient to address non-digital users.

4.2.5 Property Exchange Australia (PEXA) conveyancing platform, Australia

Model – broad description including mechanics, exclusions/limits

- PEXA provides a secure digital solution that facilitates property transactions for conveyancers, lawyers and financial institutions. Funds and documents are exchanged securely and instantly, reducing the need to handle paper documents and replacing the need for hard copy signatures with digital signatures.
- Licensed conveyancers can use their own trust account linked to PEXA or transfer funds to a PEXA subscribed financial institution. Purchasers can deposit into PEXA or into the law firm's trust account.

Benefits (including to consumers, firms and regulator)

- Stakeholders can track the progress of settlements, reducing uncertainty and improving client outcomes.
- Transactions are more transparent with real-time updates.
- PEXA integrates with banking and financial institutions allowing for easy transfer of funds.
- The platform is compliant with regulatory requirements.
- Reduced time and cost compared with traditional paper-based conveyancing.

Disadvantages (including to consumers, firms and regulator)

- Reliance on digital platform means that any outages or system failures can potentially disrupt transactions – although no evidence of this so far.
- Training and adaptation to a digital way of working may be an overhead for smaller firms.
- Risk of cyber-attack and/or data breaches – data and funds could be vulnerable if adequate protections are not in place (but probably less risk than practitioners and conveyancers handing funds themselves).
- Fees associated with using the platform could add up for frequent users or smaller transactions.

Any impact on firms and consumer access to justice of this model

- Consumers need reliable internet and devices which can be a barrier for some – putting some buyers or sellers at a disadvantage.

4.3 What are the rules on interest for client money?

Interest on client money in the legal sector is treated in two main ways (although there are some exceptions): either for the public good or paid to the client and/or law firm. In Canada, France and Australia, interest on client money is used for the public good including the provision of legal aid, access to justice and legal education although there is the possibility of setting up certain types of client accounts in Australia (eg CMA) and Canada (eg SIBTA) which pay the interest to the client. In some instances the interest is kept by the provider that is facilitating the transaction. In Canada, mixed trust accounts (e-reg trust accounts) set up to enable fees and taxes for land registry matters must pay interest to the Law Foundation of Ontario. Although when the Singapore Academy of Law (SAL) provides stakeholding services in place of a law firm, no interest can be earned. Escrow interest in New Zealand is kept by the law firm.

Typically, interest in the legal services sector is viewed as belonging to the client in the UK, Canada and Australia, although there may be circumstances when the client agrees otherwise or the interest is minimal and is kept by the legal services provider. In England and Wales it is at the discretion of the regulated law firms to decide on the 'fair sum' of interest paid to the client and/or retaining it by the firm, as long as the practitioner can account to the client. Typically firms will pay clients a specified rate which they themselves consider fair, with some kind of de minimis amount set eg withholding interest if it is less than £20 a year. In the USA, the rules vary by state, some firms can retain interest under certain conditions and this must be specified in client engagement agreements. In most jurisdictions law firms need to be transparent with clients about how interest is handled and obtain consent and must also comply with any tax implications.

Amongst other professions in the UK, material interest earned on client money is typically considered to belong to the client. In the accountancy profession, regulatory guidance states client funds should be placed in an interest-bearing account unless the interest earned would not be material. Whether interest would be material is determined according to the number of weeks the funds are to be held and the minimum balance. For example, a £1,000 balance held for eight weeks should be placed in an interest-bearing account, while a £20,000 balance would need to be placed in an interest-bearing account if held for one week[8]. Accrued interest is paid to the client. In all professions examined, firms can agree alternative arrangements with clients.

4.4 Accountability

Typically across the jurisdictions under consideration, accountability approaches are shared in three main areas:

- individuals having direct responsibility for handling client money eg bookkeeper or trust account supervisor
- support roles or functions including finance and compliance
- managing partners/sole practitioners having oversight of the process to comply with client money regulations and being accountable for this being conducted responsibly.

In some areas this means that the responsibility for managing client money falls on the firm's partners or senior management collectively, rather than a single designated individual. Lawyers can delegate responsibility to non-lawyer employees in some countries which may either expose additional vulnerabilities or be a better use of time and expertise. In New Zealand for example, the role of the Trust Account Supervisor (TAS) is a key component of the regulatory framework. The TAS is a nominated individual who has clear accountability within the specific framework of trust account regulations and must be trained and certified accordingly. In UK insurance, brokers need to appoint a client money manager to manage the non-statutory trust client bank account to ensure additional controls.

4.5 Enforcement and compliance

In terms of enforcement and annual checks, many jurisdictions have a model whereby an annual inspection or compliance check of client money accounting is conducted by an external auditor. Some firms fund the inspection themselves (Australia), for others the cost is borne centrally (Canada) unless extra work or subsequent visits are needed in which case the cost may be borne by the legal practice (New Zealand). Australia in particular has strict audit requirements. In the UAE, there are annual audits plus regulatory authorities such as the DLAD (Dubai Land Department) or ADJD (Abu Dhabi Judicial Department) may conduct spot inspections to ensure compliance.

Most jurisdictions have a mix of annual independent audits plus inspections or reviews at the discretion of the regulator as part of a risk-based approach in response to specific concerns or referrals. Firms must also submit audit reports and maintain records for regulatory review. Regulatory bodies also have mechanisms for handling client complaints relating to the handling of client money which can trigger enforcement action.

In most jurisdictions under anti-money laundering and financial crime legislation there are set limits on the amount of cash that legal practitioners can receive and these rules may give rise to the need to report a suspicious transaction.

The SRA does not directly approve specific financial institutions for handling client money, whereas in some jurisdictions the regulator approves a limited number of institutions that are authorised to hold money on behalf of law firms (Australia, New Zealand, Singapore).

4.6 Use of technology to either reduce risk or to assess compliance

The SRA could consider the use of a dedicated technology solution by learning lessons from existing solutions, such as: PayProp which collects money for letting agents, holding dedicated client accounts with banks and offers automated client accounting and reporting; PEXA UK, or MyTrustAccount in Canada which provides lawyers with a secure online management system for trust information and to which the regulator has access.

From July 2024, law firms in New Zealand are required to use Audit Assistant, a cloud-based auditing tool that the Law Society's Inspectorate uses to conduct trust account reviews and to assist in detection and enforcement – both by increasing the number of reviews that can be conducted and streamlining the process of receiving documents and information required for a review. An Australian regulator, the Law Society of New South Wales, has vetted trust money software for compliance and issued certificates to 23 providers.

The advantages of technology include real-time tracking and reporting which could be integrated with the SRA's own oversight systems to provide an early-warning system and prompt spot checks or audits.

Client transparency

Providing clients with visibility over their money increases transparency, trust and reduces the risk of misappropriation or misallocation. Shieldpay's platform, used by some law firms, enables end-clients to see transactions on their accounts[9]. Other digital platforms that offer end-clients this visibility are in evidence.

- In addition to providing letting agents with real-time visibility of their client accounts, property payment and bank reconciliation platform, PayProp, enables landlords to view any money processed on their properties via a free 'Owner' app[10].
- Nordic virtual account provider, Tietoevry enables end-clients to view balances and transactions, while operational control of holdings remains with the client money account holder, including asset managers, pension funds, insurance providers and real estate agents[11].

Traceability and governance

Many digital platforms offer authorisation and tracking processes that increase oversight over client money and protect against misappropriation of client funds. Readily visible, real-time client and office transaction histories and account balances are common features, along with built-in warning systems and automatic anomaly reports.

- Shieldpay provides notifications when funds flow to assigned parties. It also has transaction monitoring procedures in place and undertakes spot checks on transfers between TPMAs and the law firms' operational accounts to identify unusual transactions[12].
- Virtual account providers such as Cashfac offer an audit trail of activities, with transaction traceability from origin through initiation[13]. It also enables businesses to create user controls via customisable authorisation models[14].
- Payprop similarly allows customers to set custom user permissions for every type of system action, and see detailed, date-stamped audit logs of all users' actions[15].
- Corporate-to-bank integration providers, AccessPay, connects accounting systems with banking portals, so that payments are made from the AccessPay platform and registered on the accounting ledger. This reduces the potential for fraud and error, as fewer individuals have access to the bank portal to make payments and manually downloaded statement data cannot be manipulated when reconciling accounts.[16]
- Legal sector software providers such as Quill and Cashroom validate bank accounts and sort codes of payees for every transaction. Cashroom's authorisation workflows enable law firms to establish robust approval processes, with configurable authorisation levels and real-time tracking capabilities[17].

Improving efficiency

Technology is also reducing the burden of handling client money, simplifying and automating workflows and reducing reliance on manually intensive, error-prone processes. Examples include automatic matching and allocation functionality[18], along with continuous and instant reconciliation of client accounts. This is offered by a range of providers including legal sector practice management and accounting vendors, virtual account providers, bank integrated property payment systems and reconciliation platforms and TPMAs.

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9 Legal Futures webinar: 'Should solicitors continue to hold client money?', May 2024
10 How PayProp can help with CMP insurance | Propertymark
11 https://www.tietoevry.com/en/banking/transaction-banking/cash-management/client-money-management/
12 Third-Party Managed Accounts: Your questions answered
13 Platform - Cashfac
14 Virtual accounts: a convenient and efficient way to manage client funds
15 PayProp | Industry Supplier | Propertymark
16 AccessPay: Your flexible and secure bank integration solution
17 Law Firms of the Future – Cashroom's Cashiers Embracing Cutting-Edge Technology
18 Protecting Client Money: Best Practices | Cashfac, https://www.tietoevry.com/siteassets/files/banking/tietoevry_client-money-management.pdf

Virtual accounts held with an electronic money institution and managed online are sub-accounts of a primary account. Virtual accounts are an option for entities that want to reduce the number of physical accounts they manage. Virtual accounts are different to online accounts offered by traditional banks (online banking) and often more cost effective. When virtual accounts are linked to a single physical bank account also simplify and speed up the process of opening and managing designated client bank accounts, while offering greater visibility and control. Self-service functionality means that firms can create and maintain these virtual accounts, which can be consolidated into a single view[19] providing real-time visibility and operational control of client funds. Providers like Cashfac claim to offer continuous compliance with complex client money rules requiring segregation and reconciliation, meeting the client money protection requirements of different sectors such as accountants, lawyers, bookmakers, pension providers and property managers[20].

Other notable technology-enabled features or benefits offered by third party providers include:

- eliminating emails when it comes to communicating on transfer of monies[21] (reducing the risk of email-initiated cybercrime) and the need for rekeying data[22]
- dashboards, shared workspaces and apps that allow firms to track the progress of transactions, have visibility over all parties' actions and gain oversight of their accounts quickly and efficiently
- integration with open banking technology and/or internal back-office systems streamlining processes and ensuring accuracy and reliability
- automated anti-money laundering (AML) and know-your-client (KYC) checks.

4.7 What are the levels of consumer protection?

Compensation funds operate in Australia, New Zealand, Quebec and Singapore in which practitioners who hold client money make a modest annual contribution in order to provide a fund for consumers to seek redress if they have suffered financial loss due to a law firm's dishonesty, fraud or failure to account. The primary purpose of compensation funds is to provide a safety net for clients who have experienced financial loss through unethical or unlawful actions by their law firm. In the UAE, lawyers may be required to obtain a bond or insurance policy as there is no central fund. No compensation fund is needed in France as under the CARPA system lawyers do not have access to client money. Some payments to compensation funds are linked to the practising certificate or annual membership. Exemptions for those practices that do not hold client money are in place in the UK, New Zealand, Australia and Canada. Even if a firm does not handle client money, PII needs to be maintained. Although where client money is held centrally eg in France, PII costs are much lower.

Other consumer protection measures are in place including guarantees under consumer law in Australia and the UK (the Financial Compensation Scheme in the UK as well as statutory provision under the Consumer Rights Act 2015), consumer protection statutes in Canada, and Quebec has a legal warranty of quality in the civil code. Consumers of legal services in New Zealand are also protected by the Consumer Guarantees Act and the Fair Trading Act. Most jurisdictions have a process for complaints handling and resolution as well as standards around professional conduct. In addition, clients across all jurisdictions can seek recourse through the judicial system. Legal aid to consumers is available for this in Australia, Canada, Singapore and New Zealand.

Turning to other sectors, property managers and agents are legally obliged to belong to an approved Client Money Protection (CMP) scheme, which covers consumers in the event of misappropriation of funds. Companies pay an annual levy and must display their membership logo. In the financial services sector, the Financial Services Compensation Scheme (FSCS) provides consumer protection in the event of a regulated firm failing and in certain instances, mis-sold products or fraud.

5 Future of handling client money

When looking at future developments in how client money is handled by professions and jurisdictions, there are innovations and developments that have been identified as potential enablers of change.

In the short term,

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20 Client Money Management and Compliance - Cashfac
21 Law Firms of the Future – Cashroom's Cashiers Embracing Cutting-Edge Technology
22 Legal Accounting Software for Solicitors | Law Society Approved | Quill

- the use of **blockchain** (secure distributed digital ledger) enhances security as client funds are transferred outside of traditional banking systems which are vulnerable to hacks. The risk of fraud is reduced as the transaction history cannot be changed, making the audit trail transparent and immutable.
- **Outsourcing** certain aspects of client money handling, such as account reconciliation or audit preparation, to specialised providers can reduce costs and free up internal resources for firms. This can also include delegating responsibility to non-lawyers for aspects of client money management.
- **Centralisation** of client money handling within a firm or across multiple offices can improve oversight and reduce the risk of fraud or misappropriation. This can be combined with an individual with nominated responsibility for the client accounts such as the TAS in New Zealand, delegating responsibility to non-lawyers.
- Firms can make use of **open banking technology** to automate the connection between online banking and their accounting software. For large firms, where open banking rules do not apply, corporate-to-bank integration technology that connects bank portals and accounting systems can be used. This eliminates the need for manual transfer of data from bank portals or paper statements to the accounting system, which is a common point for data to be manually manipulated or re-keyed to carry out fraud. This can also improve efficiency and reduce the risk of errors and fraud in managing client funds.
- **New payment regulations and requirements**: new standards and initiatives such as Confirmation of Payee (CoP)[23] technology and the ISO 20022[24] financial messaging framework, which is being rolled out worldwide and enables detailed data to be attached to transactions, are contributing to the fight against fraud. These initiatives are being led by the financial services industry but will also impact corporate entities. CoP technology is increasingly used by finance teams in companies to avoid misdirection of funds, while all firms will need to collect more detailed and structured data for transactions as part of the transition to ISO 20022.
- **Legal practice management** providers such as Clio and cashiering platforms could move into the client account management space as the market develops given their existing platform capabilities and would have the ability to provide transparency, accessibility and help to support audit requirements.

Blockchain and open banking in particular put control of financial data in the hands of consumers and enable them to share information with trusted third-party providers as well as financial institutions.

In the medium to longer-term:

- **Smart contracts** where payment terms are directly written into code so funds could automatically be released once certain conditions are met – so payments could be self-executing, reducing risk of human error (although there are questions whether regulation applies to smart contracts and how enforceable they are).
- **Artificial Intelligence** may well offer benefits in detecting and reducing fraud, KYC checks, streamlining existing workflows and further reshaping the payments industry.

6 Conclusions

Having reviewed the evidence from other jurisdictions and professions, these common themes emerge as key considerations, should the SRA wish to further explore alternative models for holding client money.

- Any model must have **robust regulatory oversight** or built-in structures that work to protect client money without the need for a central authority, if client money is held.
- **Consumer protection** from fraud, misuse or mis-management must be built in such as the provision of PII and/or compensation funds proportionate to the risk of holding client money.
- **Administrative efficiency** is important - to reduce the burden of compliance on law firms, to enable non-lawyers to have administrative responsibility and to reduce overheads in audits and reporting.
- **Technology** – such as open banking technology, blockchain and other portals and systems can be deployed by regulators and firms to help manage the process of outsourcing client money handling and reduce costs by using existing platforms.

23 Confirmation of Payee
24 ISO 20022

- **Visibility** for regulators - some online portals for client money (eg My Trust Account, Canada) enable the regulator to have visibility of all the transactions made, providing an early warning system for error and/or fraud.
- **Accessibility and transparency** for clients - visibility of their money, any interest earned, dates that payments are made, self-service portals where disbursements can be made directly to the third party rather than via the law firm.
- **Data** on transactions and compliance checks must be resistant to alteration - making information sharing transparent and secure.
- **Security** of any client money system – safe from hacking, from data breaches, from bad actors as well as resilient and protected from downtime, outages and service failure.

There are of course challenges for law firms in shifting to new models including changes to processes, systems and culture, and potential cost implications. For the regulator and for firms there is a requirement to provide reassurances for consumers about the security of other models. However, it is possible that some of the models identified could be applied to sub-sets of the legal sector in the UK with the aim of calibrating the approach to compliance to the size or type of the firm (and proportionate to the risk). Existing technology platforms can play a fundamental role in this.

It could be useful to conduct a deeper dive into alternative models and elements of technology enabled solutions to try to understand the current size and scope, for example number of firms using these services. Similarly, it could be useful to access data on the number of firms that actually manage client accounts in jurisdictions where firms can opt out of handling client money – either by approaching regulators directly and/or an open access data request as this information is not yet in the public domain. Finally, data are not available (in the public domain) for exactly how the value and volume of client money held and moved differs across the profession which could be useful to understand in more detail. With thee data it might be possible for the SRA to assess whether to take a sector-based approach, applying different client money handling rules to different situations based on the risk involved, whether that is size of firm and/or type of firm. Some of the models outlined in this research could be considered either wholesale or in combination. Options include:

- Requiring some sectors of the profession to use client money protection through **third party services**. Examples include TPMAs, escrow services, virtual accounts and/or even dedicated client money management platforms managed by regulators (My Trust Account in Canada).
- **Client account insurance models** – separate client account insurance policies required at firm level to cover any misappropriation which could provide a separate layer of protection for clients over and above PII and Compensation Funds. (In the UAE a separate bond or insurance coverage is required, determined based on the scale of the legal practice and the nature of the services provided and designed to be sufficient to cover potential claims arising from any mishandling of client money).
- As part of a **tiered approach**, imposing more stringent requirements on firms that hold a higher value or volume of client money, potentially even removing the option of a client account for specific firms deemed to be high risk. A tiered approach could ensure that compliance overheads and consumer protections are proportionate to risk.
- Some or all firms could be required to use SRA-approved financial management platform that provide built-in compliance. Client money could be **centralised** by certain firm size for example sole practitioners could pool client money in a regulator-mandated single technology platform eg CARPA.

Our recommendations would be to consider these options in light of the findings of the Consumer Protection Review, and together with the data, consider the feasibility of applying a segment or sector-based approach to the handling of client money and consider implementing, or piloting, alternative models where the greatest areas of risk are identified (size or type of organisation, practice area etc), provided that law firms are not overly burdened with compliance costs and consumers are fully protected. It is suggested that the SRA consider the use of existing third-party technology solution(s) as part of this approach.

Appendix 1: How client money is handled in other jurisdictions

Appendix 2: How other professions and the financial services sector in the UK handle client money
Appendix 3: Third-party providers reviewed

The SRA commissioned this research from an independent research agency, Spinnaker Research & Consulting. Set up by Jemma Macfadyen, Spinnaker specialises in in-depth qualitative research in the legal sector and has been providing market research, data analysis and strategic support to publishers, regulators and membership organisations in the UK and Europe for over 25 years. Spinnaker provides research expertise to a range of legal regulators, professional bodies and membership associations to contribute to policy evaluation and development. Spinnaker also works closely with

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