LEGAL SERVICES CONSUMER PANEL

Sent by email only to: consultation@sra.org.uk

21 September 2016

Dear Sir/Madam

## Looking to the future: Accounts Rules Review

The Legal Services Consumer Panel welcomes the opportunity to respond to the Solicitors Regulation Authority's consultation on reviewing the Accounts Rules.

We support a move towards principles based regulation because we recognise that overly prescriptive rules lack the capability of being applied flexibly to a changing sector with multiple and diverse players. We also note that a principles based approach is more likely to produce behaviour which fulfils the regulatory objectives, and is easier to comply with. In contrast, detailed rules may leave gaps, produce inconsistencies, lead to rigidity, and may be susceptible to creative compliance.

However, there are also risks and challenges attached to the principles based approach, amongst which are; uncertainty, unpredictability, lack of accountability, inappropriate skills and mind-set of the regulators and the regulated community to make it work, as well as the proliferation of accompanying guidance. Therefore, to be successful a principles based approach in itself is generally not sufficient. What must accompany this approach is appropriate supervision and enforcement, accountability, and crucially the identification of fixed points where more detailed rules might be needed. In our view, dealing with client money is one area where a principles based approach needs to be supported by clear rules and outcomes for the following reasons:

- misconduct poses high risk to the regulatory objectives
- a reduction in consumer protection would lead to consumer detriment which may be significant for vulnerable consumers
- the commercial incentives for firms to get it right are weak

Although we agree with the SRA's overall direction towards a principles based approach, we have some concerns about the details. Our response focuses on these in the hope that it stimulates further consideration and improvement of the proposals under consideration.

## Definition of Client Money

The Panel agrees that there should be a clear and standardised definition of client monies. However, the proposed change is problematic because it removes a fundamental consumer protection. Consumers who pay in advance for services and/or for their disbursements will no longer benefit from the protection of their money being automatically returned should the firm become insolvent. They will become unsecured creditors. This is a significant reduction in consumer protection. The SRA argues that this will remove the need for some firms to have both a client and office account, reducing the associated compliance costs of running client accounts. While the Panel is sympathetic to the desire or obligation to reduce regulatory cost or burden, where this involves a reduction in consumer protection we expect to see clear evidence of the savings and positive impact on firms. This evidence has not been made available. Although the SRA has clearly set out the reductions in consumer protection, and outlined the potential impact of these by using illustrative examples, the assertions around savings and other advantages for firms are not backed up with the evidence necessary to gauge whether the right balance has been struck. It is extremely difficult to assess the trade-off between reduced protection and the alleged benefits of reduced cost and burden to firms.

Moreover, the SRA states that firms will still be required to deposit stamp duty and land tax into client accounts. This suggests that client accounts will continue to exist alongside office accounts for some firms. If client accounts continue to exist, the Panel finds it difficult to understand how the costs of maintaining them will be reduced by simply removing the requirement for advance fees and disbursements to be deposited into them. If the argument is that some firms will no longer need to have clients' accounts because they do not deal with property or probate matters, then the Panel expects to see a detailed assessment of the type of firms these are, or might be, their numbers and so on. Consideration may then be given to whether these firms can bypass the need to have a client account by not taking client money in advance of service. Instead, such firms could charge a fixed fee or bill on invoice. Indeed what is missing from the consultation is a detailed consideration of other options that may simplify the account rules and reduce regulatory burdens for solicitors.

It is important to emphasise that firms have the option to offer services on a fixed fee basis thus avoiding the burden of running client accounts. Firms may also contract out the management of client accounts. Furthermore, firms may choose to bill on completion of services or at specific times e.g. at key milestones. Against these considerations, we feel that it is disproportionate to shift the burden of loss onto consumers. If solicitors require advance payments before work is carried out, then the funds should continue to be protected. Solicitors have the benefit of knowing that the money for the work they are undertaking is there for them to draw on when the work is completed. Consumers deserve to be reassured that their money is safe and protected in the event of the firm becoming insolvent. Anything less, in lieu of solid evidence, puts consumers at a disproportionate risk, and is likely to incentivise poor behaviour.

We note that the Financial Services and Markets Act 2000 enshrines a similar principle into legislation. This ensures that client money is kept separate and not used by financial firms for their own purposes.

Finally, the Panel is also concerned about the associated relaxation of the requirement on some firms to submit their accounts. Again we note that there has not been a thorough analysis of the number of firms this would impact, and how it may affect consumers. Crucially, there is no consideration of the perverse incentives this may lead to. It is our view that the redefinition of client accounts along with a relaxation of the requirement to report, is likely to create incentives that may produce very poor outcomes for consumers.

## Mixed Accounts

The Panel's position on the redefinition of client money has informed its position on mixed accounts. Our concerns over reduced consumer protection outlined above lead us to conclude that mixed money should not be paid into office accounts. Instead, we support the proposal to pay mixed money into client accounts and for the money to be redistributed promptly afterwards. The use of the word 'promptly' may be problematic for providers and other professionals', for example reporting accountants. The SRA needs to understand how providers might interpret this word. It should also consider guidance in this area with a focus on good outcomes.

The Panel strongly disagrees with the SRA's assertions that section 75 of the Consumer Credit Act 1974 can act as a safety net for consumers, or be relied upon as a result of the reduction in consumer protection flowing from the redefinition of client money.

The Panel notes that it is not an easy task to make a claim under section 75. Aside from the hassle of making a claim against the credit card company and having to provide all the necessary evidence, and exercise the persistence necessary to pursue it, there is the question of consumer choice and access. In the Financial Conduct Authority's occasional paper 17 on Access to Financial Services in the UK[1] evidence shows that access to credit cards is patchy, particularly for vulnerable consumers; consumers who may need help with immigration, family, welfare or housing law. These consumers will not necessarily have a credit card, or may have little prospect of obtaining one.

The report notes that one large bank turned down over 90% of applicants who had thin or empty credit files, and 30% of applicants in rented accommodation compared with 10% of home owners. Also, there are varying attitudes towards borrowing among retired consumers with resources, some rarely go overdrawn or take on debt. 65% of this group have a credit card, but the outstanding balance is often less than £50 and balances are almost always paid off each month. These older people may have legal problems yet would not necessarily want to use a credit card or, in the case of those on a budget, will have chosen not to have a credit card in the first place. It should also be noted that if payments are made online, it is fairly common for some businesses to charge more for payment by credit card so they can recover the merchant acquirer fee. This cost is likely to be passed on to consumers, making legal services arguably more expensive.

Furthermore, section 75 applies only where there is a relationship between the lender, supplier and creditor. If the consumer makes a cash withdrawal, or pays via money transfer into their own personal account (as is widely available and promoted by credit card companies) that money will not be protected under section 75 because the necessary link between the borrower/supplier/creditor will not be considered as existing. We also note that the circumstances under which a section 75 claim would be successful is restricted to misrepresentation and or breach of contract. This is a narrow set of criteria.

The Panel is not convinced by the assertion that rights in other consumer protection legislation can be relied upon by the consumers, especially as these have not been outlined in detail by the SRA. Consumers do have recourse to the courts, but evidence shows that consumers are often reluctant to pursue litigation, even at the Small Claims Court which is geared towards a litigant in person, for numerous reasons. More importantly there is also an upper limit of £10,000 for small claims proceedings, lower than the upper limit of £30,000 under section 75 of the Consumer Credit Act. And there are court fees to also take into consideration. Indeed the varying levels of monetary remedies available in the

[1] https://www.fca.org.uk/publications/occasional-papers/occasional-paper-no-17-access-financial-services-uk

routes suggested by the SRA is another reason against the proposal to redefine client account. At present consumers enjoy a uniform remedy should something go wrong; a full refund.

Finally, the Panel cannot agree with the passing on of responsibility to another regime, one designed to be a backstop for consumers relying on a financial services product. This is in our view tantamount to abdicating responsibility that must reside with the SRA who are obliged to protect consumers of legal services.

**Compensation Fund**

The SRA notes that the compensation fund also offers some consumer protection. However, in the Panel's research and report into financial protection arrangements in 2013 we argued that the present arrangements are unsatisfactory. Specifically we highlighted the discretionary nature of the SRA's compensation pay outs. We also highlighted that in some cases there are tests that must be met before a grant can be paid, for example a hardship test, and that the criteria for such tests are not always transparent. Other evidence suggests that claims on compensation funds can be rejected for reasons such as being out of scope.

The assertion that consumers can rely on the compensation fund must be balanced against the SRA's wider proposals to deregulate this area by not making it mandatory for all the individuals it regulates to contribute to the fund. It is unclear whether solicitors who do not operate a client account will be required to contribute into the compensation fund. This will clearly have an impact on what protection is ultimately available to consumers.

**Third Party Managed Accounts**

The Panel agrees with the SRA's proposal to allow firms to use alternatives to holding client money through the use of a Third Party Managed Account. We agree that this should be an option for firms and not a mandatory requirement. We are also supportive of the criteria outlined by the SRA. However, in our view these are mandatory criteria, not just desirable ones. They are fundamental to ensuring that the proposal works in both the interest of consumers and providers;

- there is independence of the third party from the transacting party
- there is transparency of status and ownership of the third party
- that the third party is regulated by the Payment Services Regulator (under the umbrella of the Financial Conduct Authority)
- that there are clear mechanisms for dealing with disputes
- that there are clear provisions for termination of the arrangements

We hope our comments and concerns serve to improve the thinking behind these proposals. Crucially, we would suggest that this consultation would benefit from including the necessary evidence to justify some of the significant changes it proposes. Without this evidence it is difficult to gauge the impact of the proposals on consumers and other stakeholders.

If you would like to discuss this further please contact Lola Bello (lola.bello@legalservicesconsumerpanel.org.uk).

Yours sincerely

Elisabeth Davies
**Chair**