Solicitors Regulation Authority

Client money in legal services- safeguarding consumers and providing redress

A response by the Association of Personal Injury Lawyers

13 February 2025

Introduction

APIL is the UK's largest claimant injury lawyers association. This year marks 35 years of campaigning in the space, representing our members and speaking on behalf of those they represent. Our response to this consultation is based on our knowledge of the personal injury and medical negligence sector. Making a claim for personal injury is a distress purchase. Claims of this nature involve the most vulnerable in society. It is crucial that these individuals are protected and includes robust regulation of those that represent them.

Part 1- The model of solicitors holding client money

We oppose changes to the way in which client money is held, the current systems work well allowing firms to adopt the most appropriate process that works best for them. The SRA should not, in our view, be looking at overhauling the way in which client money because of the regulatory failure of the last 3 to 5 years. There should be a greater emphasis on ensuring that the necessary controls are in place to stop breaches happening.

Q1. We want to ensure we fully understand the issues firms encounter in returning excess funds to clients or third parties – please outline:

- **the circumstances in which residual balances may arise on a particular matter**
- **the steps that firms can take to make sure their client contact details remain up-to-date and any challenges with doing this**
- **mechanisms that firms use to trace clients/third parties and any challenges with this.**

Our experience suggests that where firms have good systems in place to keep clients updated throughout the life of their claim, difficulties returning money to the client rarely happens. In PI cases firms rarely experience difficulty in returning excess funds to a client. In a small number of cases where small amounts of residual money remain on the account it can occur for example as a result of rounding on an invoice. In recent years members have found that the move towards a greater uptake in electronic payments, rather than cheques, has also made it less of a problem than it used to be. Members find that consumers change

banks infrequently and therefore it is easier to refund smaller amounts of money. Historically refunding small amounts of money by cheque could result in an individual failing the cash the cheque and this would not be known by the solicitors until the cheque had expired some six months later.

Q2. Do you agree that we should replace the term 'promptly' in rule 2.5 of the Accounts Rules and introduce more prescriptive requirements around returning funds to clients and third parties?

It would be helpful for there to be greater clarity around timeframes, this would allow firms themselves to then be able to provide more information internally on what the expectations are to fee earners. It would also be helpful to have guidance on what 'residual funds' means.

Q3. Would a 12-week timeframe, from the conclusion of a case, provide sufficient time in which to identify an excess balance on a client account and return the funds to the client or third party where the firm holds their up-to date contact details?

If not, please give your reasons and include any specific examples of relevant issues.

Q4. Should it not be possible to return excess funds to the client or third party within 12 weeks of the conclusion of a matter, is a further 12 weeks a reasonable timeframe to make all reasonable attempts to trace the relevant client/third party and where this is unsuccessful, donate the residual balance to charity or apply to us for approval to do so?

In response to question 3 and 4, our view is that in most instances 12 weeks would seem a reasonable timeframe, it does not seem too onerous for our sector. However, there is always an exception to the rule and other sectors within the legal profession may require longer. It is important for the SRA to ensure that where there is good reason this is not complied with the reason is taken on board. We would favour a reasonably practicable approach, rather than an absolute rule. We know for example that where cheques are not cashed, they have a validity for 6 months, this would fall outside of the timeframe. Where a case is subject to probate because of the death of a client, this would also fall outside the timeframes. There are also likely to be delays on a case where you are dealing with a government department.

Q5. We would like to understand current practices around interest on the client account. Please tell us about your experience of the arrangements for interest on clients' money, including:

- **The extent to which client accounts generate interest, and – if so – how interest is apportioned between the firm and the client?**
- **Any arrangements firms have to receive less or no interest on client accounts and what, if anything, the firm receives in return?**
- **Whether and how firms make their clients aware (either directly or via terms and conditions) that their money could earn interest?**

- **Whether clients are aware that firms may retain some of the interest earned on their money?**

Practices vary significantly from firm to firm. We understand that some firms follow a de minimis rule, for example sums under £20 will not accrue interest as the administrative cost of doing so would be more than the interest itself. Some firms have multiple client accounts with different banks so different rates may apply. Other firms may apply a benchmark amount to interest on client accounts.

We can see the benefit of firms being able to have different arrangements with their banks and with their clients as suits them. Clients are always advised on what arrangements are in place. Clients therefore have the ability to shop around for an alternative if they wish. In our sector client money is paid for good reason e.g an interim payment on damages towards treatment costs, and is therefore unlikely to be sat in client account for very long. Our experience therefore is that interest on client account is not much of an issue.

Despite this we accept that all firms are not the same. Some maybe holding large amounts of client money, whilst others may not. The consumer view that they want interest paying on money held in a client account whilst an important one, is one issue is a very complex market. A firm that is offered reduced banking overheads as a result of arrangements with their banking provider may offer reduced fees to their client. We would suggest that the SRA approach some of the banks to find out what commercial arrangements are available as these are complex commercial arrangements that need to be fully explored.

Q6. What are your views on the suggestion that we amend our rules to prevent firms retaining any of the interest earned on client money (subject to a de minimis)?

Q7. Are there circumstances where firms retaining some of the interest earned would be of benefit to the client?

Q8. What do you think would be the impacts of removing the ability for firms to earn interest on money held in client accounts? How could any short-term and/or long-term challenges be overcome?

In response to question 6, 7 and 8, also see above response to question 5. Our view is that this is not a case of one size fits all. Firms should have the choice to shop around for the appropriate arrangement that suits their business model. The rules should not prevent firms being able to be competitive in a very difficult market, so long as the client is advised of the situation and are free to shop around if they wish. We caution against change due to the risk of unintended consequences.

Q9. Are there any circumstances in which it is in the client's best interests to transfer client money from the client account to the office account before the work to which it relates has been completed? If so, please describe these circumstances.

This is not relevant in PI and therefore outside of our remit.

Q10. Do you agree with our proposal to progress the amendment to rule 2.1(d) of the SRA Accounts Rules? Please explain your answer.

This is outside out remit.

Q11. Do you agree with our proposal to progress the amendments to rules 4.3, 4.3(a) and 4.3(c) of the SRA Accounts Rules, and the addition of rule 4.4? Please explain your answer.

This is outside our remit.

Q12. What are your views on the option to remove the ability for firms to enter into alternative arrangements about where client money will be held and how it will be used under rule 2.3(c)? Please explain your answer.

See above to questions 6, 7, and 8.

Q13. What approaches do firms take when calculating the amount of money they request from clients in advance? In your response, please outline:

- **Any areas of practice where you consider that it is important to take advance fees**
- **How a reasonable amount to request in advance can be calculated**
- **Any alternatives to requesting advance fees**

This is outside our remit.

Q14. When and how do you think we should, or should not, be more prescriptive about how much client money firms can request in advance of work being completed? In the areas where you think we should be more prescriptive, please outline what you think the implications would be for both clients and firms.

This is outside our remit.

Q15. What are your views of the long-term option of changing the model of firms holding client money? Please outline what you think the impact would be if firms were to hold no or substantially less client money?

Q16. In your experience, are there areas of law or services in which it is essential for a firm to hold client money? What would happen if solicitors were not able to hold client money in these areas?

Q17. Do you have experience of any alternative method(s) of holding client money (such as a TPMA or other methods)? If you have experience of any alternative method, what has that experience been? What was the impact on clients and the firm?

Q18. If you have knowledge or experience of alternative approaches to holding client money, would you be open to further discussion with us as part of future development in this area? If yes, please confirm that you are happy for us to use the details you have provided to contact you, or please provide alternative contact details.

Q19. In the context of this consultation, do you agree with our assessment of equality, diversity and inclusion considerations in our impact assessment? If not, what else do you think we should consider?

In response to questions 15,16,17,18 and 19, introducing any form of additional third party could impact the customer journey. Setting up additional/multiple accounts, dealing with additional third parties, the speed at which you can administer money, the unknown cost to the consumers for using these accounts, the small number of providers all impact the consumer journey. The volume of transactions in any one firm are substantial and therefore the administrative burden would be considerable. A personal injury firm conducting regular litigation against NHSR, or a particular insurer will have a known bank account that these defendants can pay money into it on a particular file. If there are individual accounts for every client this will be a extensive administrative change given the number of claims successfully pursued every year. Such a change will create a substantial risk of error.

The issue of missing client money is a regulatory one and not an administrative one. If the approval structures and internal safeguards are in place within firms then significant accounting change is not required. We would oppose any significant regulatory change to address a number of failures on the part of the regulator.

Part 2- Protecting the client money that solicitors hold

We are concerned that the current process for authorisation and monitoring does not provide sufficient regulation to prevent fraud or firm closure. We are of the view that there needs to be more active monitoring and regulation of firms to protect the consumer.

Comments

Most of the specific questions within this paper are largely outside of our remit. However, we have three broad comments to make.

The first is that the SRA must keep abreast of emerging trends in the market. Investment in monitoring new business models and practices is key to staying ahead of problems in the market. Collaboration with others involved in the profession, such as financial institutions and professional indemnity Insurers, would also assist with monitoring and what is happening in legal businesses. This will allow for greater focus on identifying and minimising large-scale risk. Creating a risk profile and list of red flags to allow for further investigation when those markers are raised, coupled with sharing that information with the profession to invite further feedback, would greatly assist.

Secondly, in principle we have no objection to the SRA requiring further information to be submitted as part of the annual practising certificate renewal process. We suspect that this will change as the wider sector looks at new business models and consolidation continues, however, being more prescriptive and proactive about the information that must be provided, coupled with providing guidance on what is and is not permitted, will ensure that it is as easy

as possible for firms to adhere to the rules. Outcomes focused regulation allows for grey areas, both in terms of how you adhere to it and enforce it. It is crucial that there is a right level of protection and regulatory scrutiny involved. Relying too heavily on outcomes focused regulation is not working, proving inadequate for large-scale risk.

Thirdly, a pre-approval process, additional monitoring and closer supervision should be applied to those practices that are new or changing. Authorising new entities, merges and acquisitions would allow for more forensic examination of their financial background. Linked to this we would propose greater and swifter monitoring of those individuals and firms flagged as high risk, rather than relying on self-regulation as is currently the case. The current model has led to the solicitors themselves being unhappy with the way in which the SRA is regulating firms and their practices.

APIL would suggest that rather than tinkering with the way in which firms can hold client money and limiting the scope under the Compensation Fund the SRA should look at more active monitoring and regulation.

Part 3- Delivering and paying for a sustainable compensation fund

The Compensation Fund provides an essential fall-back fund when client protection measures fail. It sets solicitors apart as providers of legal services, when compared to claims management companies and others, with an extra level of protection for legal consumers who choose a solicitor. We wish to see the compensation fund retained so that consumers are able to claim the compensation they have lost as a result of their solicitor behaving dishonestly, failing to have the proper professional indemnity insurance (PII) in place, or where there was valid insurance in place, but the policy has been voided.

We are pleased to see that the SRA is considering the way in which contributions to the fund are calculated. We agree that the market has change significantly since the original methodology was introduced. It also seems sensible to look at the ratio between solicitors versus firms. However, we are disappointed to note that a flat rate is still been proposed for firms regardless of size and /or the amount of client money held. The equality statement acknowledges that smaller firms are more likely to have partners from black, Asian or minority ethnic backgrounds[1] and the impact on this demographic should be considered further.

Q1. Do you agree that changing the apportionment of Compensation Fund contributions to 70% individuals and 30% firms is an appropriate and proportionate approach to setting contribution levels for 2025/26? Please give reasons for your answer.

We agree that steps should be taken to make apportionment fairer for profession. We also agree that the market has changed significantly since the methodology was set in 2010. However, we are concerned from the figures that this may make payments unrealistic for individual solicitors. We note that the examples of apportionment of the fund payment in the paper on page 11 work on an average fund total of 14.2 million however, the 2024-2025 contribution amounted to 31.6 million which would significantly change the levels of

[1] Solicitors Regulation Authority (SRA) ‘Diversity in law firms' workforce’ accessed online at https://www.sra.org.uk/sra/equality-diversity/diversity-profession/diverse-legal-profession/

contribution. Whilst we agree that steps should be taken to address the financial impact on smaller firms, who offer specialist services and access to legal advice that are perhaps less profitable but vital for consumers we do not think the current proposals are transparent enough. We are also disappointed that a flat rate is still being proposed for all firms regardless of risk and amount of client's money held in client accounts.

Q2. Are there any other important apportionment issues you think we have not considered here? If so, please explain what they are.

See above.

Q3. What are your views on the possibility of setting differential contribution levels for different firms?

We would welcome the SRA exploring the possibility of settling different rates for different firms. See above.

Q4. What are your views on the possible alternative methods of setting differential contributions to the Compensation Fund (based on enhanced requirements, risk categorisation, the amount of client money held, or annual turnover)?

One size fits all, whilst simplistic, does not reward those firms that have good practices in place, have accreditation, external auditors, PII etc. There is something to be said for looking at individual steps that practices have taken rather than a broadbrush approach. This should be tied in with sector analysis (See APIL's response to paper 1), and recommended firm practices that drive good behaviours. The SRA should then examine how those things impact risk. It is crucial that the SRA keeps up to date with what is happening in the sector. It may be worth exploring sector risk with professional indemnity insurance providers. All that said the cost that additional work should be balanced against the benefit of those changes.

Q5. Are there other alternative approaches to differential contributions you think we should consider?

See above.

Q6. To what extent do you agree we should move away from the current arrangements that allow us to impose a cap of £5m for connected claims?

Q7. Would you support any of the other options discussed (a flexible cap for connected claims, removing the cap for connected claims, guaranteeing compensation up to a specified amount)? Please explain why.

Q8. Are there other important considerations you think we have not considered here? If so, please explain what they are.

In response to questions 6, 7 and 8 we were pleased to note that the SRA does not intend to lower the cap for individual claims. We do not agree with any limit on the fund however, we do recognise the need for parity with individual claims and the cap that applies there. In order to provide effective protection, the limit must be set at a level below which most claims

will realistically fall, and there must also be a power to waive this limit in exceptional circumstances, so that a consumer does not lose crucial money.

In our sector a failure to be able to access the fund would leave injured clients without adequate compensation. Due to the increased costs of care and housing, it is not rare for damages in serious personal injury cases to be well over £1,000,000. In cases where personal injury victims receive high value damages, much of the money is intended to provide for future care and essential living costs. Damages are carefully calculated to provide personal injury claimants with just enough funds to meet their reasonable needs. If an unscrupulous solicitor takes some of these damages, or does not have adequate professional indemnity insurance in place to provide cover if professional negligence has occurred, the severely injured claimant will not be able to meet the cost of their future care and living costs. It is vital that the Compensation Fund remains able to rectify this even where there are multiple claims on the fund.

We do not agree with the comparison with the paper on page 21 with the financial services compensation fund cap of £85,000. If an individual has £2 million to invest, they have the option to spread the risk on that investment. This is not possible in a personal injury claim.

It is important that consumers have transparency as to what will happen in these circumstances.

Q9. What are your views on the idea of amending our Compensation Fund Rules to explicitly exclude specific types of claims? If you think specific types of claim should be excluded, which ones are these?

We do not think any claims should be excluded. Any work undertaken by a solicitor or SRA regulated firm should be covered by the fund. Consumers who have engaged a firm of solicitors will expect that work to be covered regardless of the type of transaction involved. The Compensation Fund is an essential fall-back fund when client protection measures fail. It sets solicitors apart as providers of legal services, when compared to claims management companies and others, it is an extra level of protection for legal consumers who choose a solicitor.

Q10. Are there any other considerations we should take into account in relation to payments from the Compensation Fund? If so please explain what they are.

No additional comments.

Q11. In the context of this consultation, do you agree with our assessment of equality, diversity and inclusion considerations in our impact assessment? If not, what else do you think we should consider?

We agree with the considerations in the impact assessment.

Abi Jennings

Head of Legal Affairs, APIL