



Solicitors
Regulation
Authority

Red Tape Initiative – Residual Client Balances

Consultation paper

March 2014

Purpose of the consultation

1. This consultation seeks views on proposals to amend the SRA Account Rules 2011 (SAR) relating to how practitioners deal with client money they are unable to return to clients at the end of a matter (residual client balances), including the processes surrounding the withdrawal of such funds and the basis for distribution to charities.
2. The proposals support the SRA's Red Tape Initiative which demonstrates a commitment by the SRA to review its regulatory processes and procedures and focuses here on:
 - a) reducing the regulatory burden on the profession through the increase of a minimum level of self-certification;
 - b) reducing the administration and bureaucracy at the SRA to authorise applications covering funds between £50 and £500; therefore reducing costs.
3. Currently, under the SAR, firms can transfer client residual balances below £50 to a charity without authorisation from the SRA. Where the balance is above £50 or the money to be withdrawn is not going to be paid to a charity, authorisation must be sought from the SRA. Before withdrawing any monies in these circumstances, firms must take sufficient steps to establish the identity of the owner of the money or make adequate attempts to ascertain the proper destination of the money, and to return it to the rightful owner.
4. This paper proposes amending the limit for firms to transfer residual balances to £500. Any balances over £500 will continue to need authorisation from the SRA to transfer the funds.
5. We are also considering whether residual balances should be paid only to a charity registered in England and Wales with the Charity Commission. We have considered whether we should limit the range or type of charity to which firms can transfer money. In particular we considered whether the SRA should prescribe that the charity should relate to access to justice issues. In considering this, we noted the power in Section 194 of the Legal Services Act 2007 that allows for costs orders to be made in certain circumstances, in cases where the lawyers are acting pro bono, but that the costs must be paid to a charity prescribed by the Lord Chancellor. We can see the force of argument for such a prescription. Residual balances are client monies and do not form part of any monies due to a firm or office generally. As such, it is arguable that the money should support consumer access to legal services. Furthermore, it is clearly arguable that the sum total of residual balances could have a material or visible impact in a way that small dispersed payments to charities might not. Similarly we considered if the significant range of issues covered by UK charities was in any way incompatible with our regulatory objectives. Our view, on balance, is that there is not a strong enough case for the SRA to intervene and prescribe what is in many ways a

legitimate choice. However, we are open to the views of a wide range of consumers, SRA-authorized firms and other interested parties.

Background

6. Prior to 2008, practitioners were required to obtain permission from the SRA before withdrawing any residual client balance, with the SRA assessing whether the steps taken to identify and trace the owner of the funds and return the balance to the client were sufficient.
7. In 2008, the SRA amended the rules governing the treatment of residual funds held by a firm at the conclusion of a retainer. Following these changes, practitioners were required to:
 - a) return client money as soon as there is no longer any proper reason to retain the funds;
 - b) notify clients, in writing, of the amount of money held at the end of a matter (or the substantial conclusion of a matter) and the reason for retention; and
 - c) provide a similar notification every 12 months thereafter.
8. However, to address concerns that the system was administratively burdensome, the SRA introduced a £50 limit, up to which practitioners could self-certify the withdrawal of residual client balances. In order to self-certify withdrawal, practitioners are now required to:
 - a) establish the identity of the owner of the money, or make reasonable attempts to do so;
 - b) make adequate attempts to ascertain the proper destination of the money, and to return it to the rightful owner, unless the reasonable costs of doing so are likely to be excessive in relation to the amount held;
 - c) pay the funds to a charity;
 - d) record the steps taken and retain those records, together with all relevant documentation; and
 - e) keep a central register of all withdrawals made, detailing the name of the client, other person or trust on whose behalf the money is held (if known), the amount, the name of the recipient charity and the date of the payment.

For residual client accounts over £50, or not satisfying the conditions above, practitioners must apply to the SRA for authorisation to withdraw the funds.

9. Current arrangements have been in place since 2008 and the £50 per client limit has not been changed, despite the SRA adopting a risk-based and outcome-focused approach to regulation in 2011.

Current practice and impact

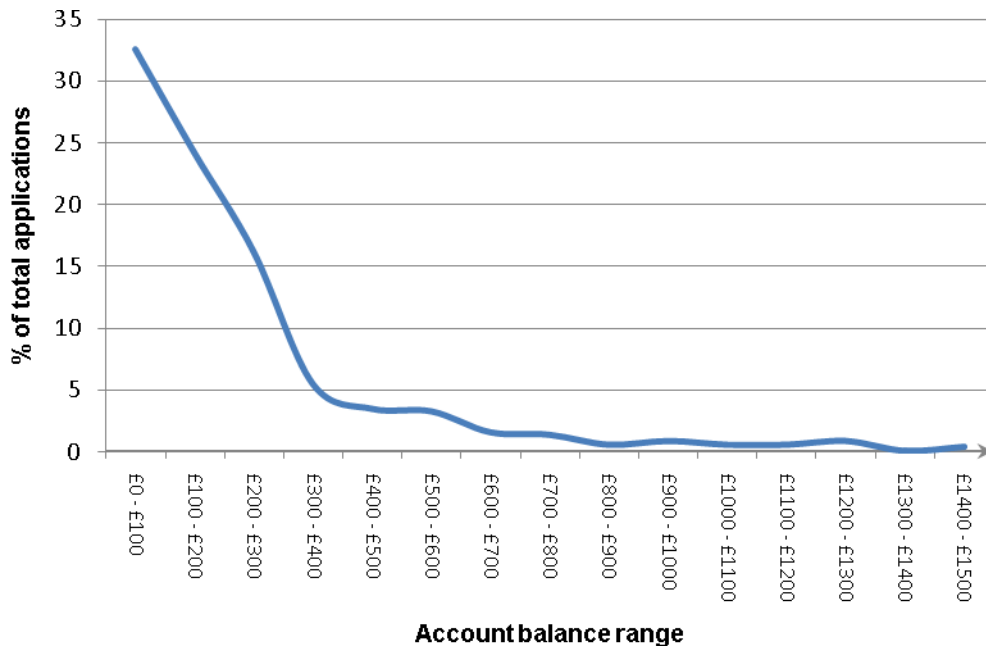
10. The number of applications to the SRA is increasing. In 2013, the SRA received 1179 applications from practitioners to withdraw residual client balances totalling just over £3.5m. Details of the application numbers for previous years are provided in the table below.

Table 1 – Number of applications for authorisation received in the last four years.

Year	Number of applications
2013	1,179
2012	993
2011	859
2010	876

11. Typically firms will accumulate a number of client balances and deal with them in one application. Applications have comprised, on average six or seven individual client balances or trust matters and the range of charities to whom the funds are distributed is wide, including large and small charities involved in an array of different work.
12. A detailed analysis of individual requests, focusing on a number of individual client balances above £50, has been carried out by the Professional Ethics Team between December 2013 and January 2014 and is presented in the Figure 1. The analysis shows that over two thirds of the applications received were for the withdrawal of balances up to £500.

Figure 1: Individual client account balances submitted for SRA approval for withdrawal (December 2013 - January 2014)



Proposed changes

13. We propose to increase the self-certifiable amount to £500. We consider this to be an appropriate level because it will allow solicitors to deal with the majority of residual balances without the added burden of applying to the SRA for authorisation. The proposal however, ensures that larger amounts, those above £500, remain under the scrutiny of the SRA.

14. This approach would allow around two thirds of the residual balances currently dealt with via an application to the SRA to be processed by practitioners without requiring prior authorisation. This represents approximately 5,000 individual client balances per year across approximately 750 applications and as such is a significant reduction on the administrative burden currently placed upon SRA-authorized firms and the SRA.

Question 1:

Do you agree with the proposal to increase the level at which practitioners can self-certify transfers of client balances from £50 to £500?

If you do not agree with the proposal, please offer any alternative suggestions for reducing the regulatory burden on firms in managing residual balances.

15. With the removal of SRA oversight for a significant proportion of withdrawals, the safeguard to ensure that practitioners take sufficient steps to reunite the funds to their rightful owner is also being removed. The SRA's view is that it is our position that this is the COFA's responsibility to ensure effective processes are in place. To support COFAs and firms to manage these risks,

we will issue guidance which provides a framework for practitioners to bear in mind when managing residual client balances. A copy of the proposed guidance is available at Annex 1.

Question 2

Do you consider that the draft guidance relating to withdrawal of residual client balances provides clarity?

If not, please explain why.

Question 3

Do you consider that the SRA should restrict the charities to which residual balances should be transferred? If yes, what criteria for selecting such charities should be put in place?

Equality impact statement

16. We considered equality impact and concluded that the proposals do not raise any concerns. Accordingly, there will be a neutral impact on equality considerations for practitioners.

Consultation questions

Consultation questions

1. Do you agree with the proposal to increase the level at which practitioners can self-certify withdrawals of client balances from £50 to £500?

If you do not agree with the proposal, please offer any alternative suggestions for reducing the regulatory burden on firms in managing residual balances.

2. Do you consider that the draft guidance relating to withdrawal of residual client balances clarifies requirements?

If not, please explain why.

3. Do you consider that the SRA should restrict the charities to which residual balances should be transferred? If yes, what criteria for selecting such charities should be put in place?

How to respond to this consultation

Online

Use our [online consultation questionnaire](#) to compose and submit your response. (You can save a partial response online and complete it later.)

Email

Please send your response to consultation@sra.org.uk. You can download and attach a [Consultation questionnaire](#).

Please ensure that

- you add the title "Residual client balances" in the subject field,
- you identify yourself and state on whose behalf you are responding (unless you are responding anonymously),
- you attach a completed [About You form](#),
- if you wish us to treat any part or aspect of your response as confidential, you state this clearly.

If it is not possible to email your response, hard-copy responses may be sent instead to

Solicitors Regulation Authority
Residual client balances consultation
Policy and Strategy Unit
The Cube
199 Wharfside Street,
Birmingham,
B1 1RN

Deadline

Please send your response by 26 May 2014.

Confidentiality

A list of respondents and responses may be published by the SRA after the closing date. Please express clearly if you do not wish your name and/or response to be published.

Though we may not publish all individual responses, it is SRA policy to comply with all Freedom of Information requests.

Annex 1 - Changes to the SRA Accounts Rules 2011

The proposed changes to the SRA Accounts Rules 2011 are shown below (deletion highlighted in red, insertion in blue).

Rule 20: Withdrawals from a client account

20.1 *Client money* may only be withdrawn from a *client account* when it is:

- (a) properly required for a payment to or on behalf of the *client* (or other person on whose behalf the money is being held);
- (b) properly required for a payment in the execution of a particular *trust*, including the purchase of an investment (other than money) in accordance with the *trustee's* powers;
- (c) properly required for payment of a *disbursement* on behalf of the *client* or *trust*;
- (d) properly required in full or partial reimbursement of money spent by *you* on behalf of the *client* or *trust*;
- (e) transferred to another *client account*;
- (f) withdrawn on the *client's* instructions, provided the instructions are for the *client's* convenience and are given in writing, or are given by other means and confirmed by *you* to the *client* in writing;
- (g) transferred to an account other than a *client account* (such as an account outside England and Wales), or retained in cash, by a *trustee* in the proper performance of his or her duties;
- (h) a refund to *you* of an advance no longer required to fund a payment on behalf of a *client* or *trust* (see rule 14.2(b));
- (i) money which has been paid into the account in breach of the rules (for example, money paid into the wrong *separate designated client account*) - see rule 20.5 below;
- (j) money not covered by (a) to (i) above, where *you* comply with the conditions set out in rule 20.2; or
- (k) money not covered by (a) to (i) above, withdrawn from the account on the written authorisation of the *SRA*. The *SRA* may impose a condition that *you* pay the money to a charity which gives an indemnity against any legitimate claim subsequently made for the sum received

20.2 A withdrawal of *client money* under rule 20.1(j) above may be made only where the amount held does not exceed ~~£50~~ £500 in relation to any one individual *client* or *trust* matter and *you*:

- (a)** establish the identity of the owner of the money, or make reasonable attempts to do so;
- (b)** make adequate attempts to ascertain the proper destination of the money, and to return it to the rightful owner, unless the reasonable costs of doing so are likely to be excessive in relation to the amount held;
- (c)** pay the funds to a charity;
- (d)** record the steps taken in accordance with rule 20.2(a)-(c) above and retain those records, together with all relevant documentation (including receipts from the charity), in accordance with rule 29.16 and 29.17(a); and
- (e)** keep a central register in accordance with rule 29.22.

Annex 2 - Proposed guidance on the withdrawal of residual client balances

First published on [1 October 2014]

Purpose of this guidance

This guidance is relevant to all practitioners who hold client money; Compliance Officers for Finance and Administration (COFAs) for firms that deal with client money and to accountants preparing applications on behalf of such firms. It is intended to assist when dealing with residual client balances (i.e. money due to clients where the client has become untraceable or where it has otherwise not been possible to return the money to the client) and designed to provide a framework that practitioners may find useful when dealing with such balances.

Relevant rules and law

Practitioners will often hold money on behalf of clients and although all client money will usually be used in the process of carrying out the retainer this is not always the case. In these circumstances, the SRA Accounts Rules 2011 (The Account Rules) require practitioners to return client money (including refunds received after the client has been accounted to) as soon as there is no longer a proper reason to retain that money (Rule 14.3).

Imposing such an obligation goes to the heart of practitioners' duties and reflects a number of SRA Principles, namely that you must:

4. act in the best interests of each client;
5. provide a proper standard of service to your clients; and
10. protect client money and assets.

However, there are circumstances where it may not be possible for a practitioner to return client money. This may be because the client has changed their contact details without notifying the practitioner, which further underlines the importance of returning client money as swiftly as possible.

Residual balances of £500 or less

Rule 20.1(j) allows withdrawal of residual client balances from the client account where the amount withdrawn does not exceed £500 in relation to any one individual client or trust matter and practitioners meet the criteria specified in Rule 20.2. The criteria, which are set out in more detail below, are that practitioners:

- establish the identity of the owner of the money, or make reasonable attempts to do so;
- make adequate attempts to ascertain the proper destination of the money, and to return it to the rightful owner, unless the reasonable costs of doing so are likely to be excessive in relation to the amount held;

- pay the funds to a charity;
- record the steps taken in accordance with the requirements above and retain those records, together with all relevant documentation (including receipts from the charity), in accordance with Rule 29.16 and 29.17(a); and
- keep a central register in accordance with Rule 29.22.

Residual balances above £500

Rule 20.1(k) allows practitioners to withdraw residual client balances above £500 from the client account on the written authorisation of the SRA. The SRA may impose a condition that the money is paid to a charity which gives an indemnity against any legitimate claim subsequently made for the sum received. In determining whether to grant authorisation, the SRA will assess the adequacy of the steps taken to identify the owner and return the funds.

It is important to highlight that practitioners will need to apply to the SRA, irrespective of the amount involved, if the money to be withdrawn from the client account is not to be paid to a charity but, for example, into the office account. This situation might arise, for example, if it has not been possible for the practitioner to deliver a bill of costs because the client has become untraceable, meaning that the practitioner cannot make a transfer from client account to office account in accordance with Rules 17.2 and 17.3.

Furthermore, in relation to the administration of an estate or trust, it will normally be the executors, administrators or trustees, or the Court, that have authority to deal with unpaid money. Practitioners should therefore satisfy themselves as to any legal requirements in relation to the money.

Establish the identity of the owner of the money, or make reasonable attempts to do so

What is reasonable will vary, depending on the situation. Factors affecting what will be considered reasonable include, but are not limited to: the age of the residual balance; the amount held; the client details available in respect of a balance and the costs associated with a particular tracing method. Larger, more recent balances, where more details are held about the client will require more intensive tracing efforts than smaller, older balances where few details are held about the client. However, the absence of client details may highlight deficiencies in your accounting practices.

The steps below provide a potential basic framework for practitioners to employ when attempting to return residual client balances. However, it is worth highlighting that practitioners may identify other processes which allow them to take reasonable steps to trace clients.

1. Client file

The client file is checked and all available contact details are used to try and contact the client or relevant third parties.

2. Companies House

If the balance belongs to a company, a Companies House search is used to identify a current address if the company is still trading. Any monies due to a dissolved company may be *bona vacantia* and payable to the Treasury Solicitor under the provisions of the Companies Act. Practitioners should clarify the situation with the Treasury Solicitor's Department before making an application to the SRA under Rule 20.1(k).

3. Internet search

If 1. is unsuccessful, an internet search is undertaken.

4. Directory enquiries

Along with 3., a directory enquiries search is undertaken.

5. Electoral Register

If a previous address is available for the client, an Electoral Register search is undertaken in the appropriate area.

6. DWP letter forwarding service

The Department for Work & Pensions (DWP) provides a tracing and letter forwarding service that can be used to forward beneficial information to clients where complete details are not held by the sender. The service costs less than £5 and has proved successful for many firms.

This service can be utilised where you have an address or previous address of the client.

Details of the DWP letter forwarding service are available [here](#).

7. Newspaper advertisement/tracing agent

The costs associated with placing an advert in a newspaper (or other similar publication) or instructing a tracing agent will depend on various factors, but we understand that such costs can start from tens of pounds. We would expect practitioners to have explored the cost implications of using these services if 1 - 6 above have proved unsuccessful.

The costs associated with placing an advert in a newspaper or instructing a tracing agent are explored. If these costs are unreasonable when compared with the balance in question, balances under £500 can be transferred to charity. If these costs are not unreasonable when compared with the balance in question, and it is appropriate given the circumstances, such services are utilised. For example, if the information held by the firm in relation to the source of the residual balance is such that it would not be possible to identify the client if such tracing efforts were undertaken, it would, in all likelihood, be inappropriate to use such services.

Record the steps and retain those records, together with all relevant documentation (including receipts from the charity), in accordance with rule 29.16 and 29.17(a) and keep a central register in accordance with rule 29.22

Taken together, these Rules require practitioners to:

- record the steps taken to try to identify the owner of the residual client balance and return the funds to them (including receipts from the recipient charity);
- keep a central register which details the:
 - name of the client or other person or trust on whose behalf the money is held (if known)
 - residual balance amount
 - name of the recipient charity
 - date of payment .

Practitioners must retain these for at least six years from the date of the last entry.

Out of pocket expenses

Where practitioners make an application to the SRA for authority to withdraw client money from a client account and incur out-of-pocket expenses, these can be taken into account by a decision maker, if the attempts to trace the client have not been successful.

However, the SRA does not have any legal authority to authorise such expenditure. If you manage to trace the client, you would need to agree deduction of the expenses from the money held. If you are not able to trace the client and the authority is granted, it would commonly be subject to a condition that funds are paid to a charity that provides an indemnity. However, where out-of-pocket expenses have been incurred, the condition would normally require only the amount over and above the out-of-pocket expenses to be paid to charity. This would not alter any liability that a solicitor would have to a client.

Please note that if you make an application for authorisation to withdraw a residual client balance, the outcome will be available to other SRA business units. If the application is granted details of the authorisation will also be publicly available if an enquiry is received by the SRA.

Further considerations

Regulatory action

Whilst we are committed to engaging with firms and practitioners, we will take appropriate regulatory action against those that fail to address the issues and risks associated with residual client balances where this is detrimental to the interests of clients.

Further help

If you require further assistance in relation to your accounting requirements, you can contact the Ethics Helpline. For our telephone numbers and opening hours, and our email and postal addresses, please visit www.sra.org.uk/contact-us.