Case studies

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Improper use of client account as a banking facility

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Before reading these case studies you should familiarise yourself with our warning notice [https://rules.sra.org.uk/solicitors/guidance/improper-client-account-banking-facility/] on using the client account to provide banking facilities - which is prohibited under Rule 3.3 of the SRA Accounts Rules [https://rules.sra.org.uk/solicitors/standards-regulations/accounts-rules/] .

You must only receive money into your client account where there is a proper connection between the funds and your delivery of regulated services. It is insufficient if there is simply an underlying transaction if you are not providing any regulated services, or if the handling of money has no proper connection to that service.

These case studies are illustrative of some of the components in the cases that we see to explain our decision making and potential outcomes.

The studies are not formal records of actual cases. If you are asked to act in a way that appears contrary to Rule 3.3 you should question why you are being asked to receive funds and for what purpose.

Further assistance is available from our Professional Ethics helpline [https://rules.sra.org.uk/contactus] .

Open all [#]

Instructing foreign lawyers

A law firm has been instructed by a client to advise on a transaction involving government bonds in a foreign jurisdiction. The lead solicitor has advised the client that the firm will need to instruct lawyers in the foreign jurisdiction to provide specialist advice. The client has asked the firm to project manage the transaction and proposed that money could be paid to the firm so that it can pay the foreign lawyers' fees.

Our view

Where regulated services are being provided by the law firm for example, the provision of advice on the terms of the bond, and the firm engages the foreign law firm, we do not consider that this scenario gives rise to a breach of rule 3.3.

Holding unconnected money in a client account

A law firm acts for an energy board and a partner at the firm is also a clerk to the board. The board holds fluctuating cash deposits, which could be more than £2 million at any one time.

At present the board receives bank interest at 0.05% per year. If this money was held in the firm's client account, the firm's bank would pay 0.7% per year. The partner's view is that this would be of great benefit to the board to hold money in the firm's client account and the firm agrees to accept the funds on that basis.

Our view

The firm is carrying out or facilitating banking activities which are prohibited by rule 3.3.

The law firm is not providing any legal or professional services which are regulated by us. There are clear potential risks that that rule 3.3 is intended to prevent, such as involvement in fraud, money laundering and possible insolvency issues. If a firm's client account is used improperly, they may also be in breach of the SRA Principles.

Development work and holding money

A law firm acts for a developer who intends to enter into a development agreement with a buyer of land. The buyer is to make payments in instalments, but it has a weak covenant strength. Buyer and seller have agreed that the total price will be paid up front to the buyer's solicitors and held by the firm. Instalments will be released when they are payable.

The development agreement will be exchanged before the monies are paid to the firm and the firm will continue to advise the client about the performance of its obligations under the development agreement while the money is held. This will include the negotiation of construction documents and utility easements and advising generally on the terms of the development agreement. The firm will also advise on the interpretation of the payment provisions in the agreement as the development progresses.

Our view

On these facts, the firm had advised (and continues to) on the development contract and other related matters. Provided there is a proper connection between holding the money and the regulated services being provided (for example, a continuing requirement on the firm to advise on whether the payments are triggered) this scenario is unlikely to breach rule 3.3.

In all such cases where money is being held in their client account, we would also expect the firm to question whether there is a proper reason for the funds to be held by them, rather than paid directly between the parties. The circumstances should also be kept under review to make sure that holding the money remains proper and justifiable.

Unconnected payments from client account

A law firm acted for a property development company. The original retainer related to a redevelopment of a block of flats, the creation of separate leasehold interests and sale of the individual leases.

When the flats were sold, the client asked the firm to retain the proceeds in the firm's client account. The company then asked the firm to make a series of payments from client account, using the proceeds of sale from the first development to pay a building contractor, architect and council tax in relation to another development site, and to pay £56,000 to a consultant for his services as a sales agent.

The consultant then asked the firm to split the payment to him - paying £9,000 to a car dealership as a deposit on a new car and the balance to another firm of solicitors as a deposit on a property he was purchasing. The firm was not instructed to provide legal advice about the second development site. Its role was limited to making the requested payments.

The firm later found out that the consultant was in the process of going through a divorce.

Our view

There is a clear risk here that in making the payments the firm would be in breach of rule 3.3.

Making prompt payments on behalf of a client to third parties connected with a conveyancing transaction on which a law firm acted, such as to sales agents, is unlikely to breach rule 3.3. However, the less connected the payments are to the delivery of regulated services, the higher the risks are that the firm may breach rule 3.3.

Here, the payments relate to other transactions on which the law firm was not acting. Developers also frequently use different companies as special-purpose vehicles for each development and solicitors must be

very wary of the risks in receiving funds that belong to Company A and paying them to Company B or to pay a liability of Company B.

Firms should also ask themselves why the money cannot simply be paid to the client which can then make payments itself. Even if the liabilities are all the client's, it remains very risky to pay these when there is no reason the client cannot do so itself. The client's convenience is not a legitimate reason. We would expect the firm to be able to explain fully why the payments are being made and to have fully considered the risks involved – for example, involvement in money laundering, avoiding money being caught in an insolvency, or the hiding of assets.

Investment scheme and an 'escrow' arrangement

A law firm was instructed to act as an 'execution only escrow agent' in a proposed investment transaction and was also referred to in the contracts used as the 'Paymaster'. The retainer was purportedly limited to reviewing the terms of an 'escrow agreement' and to release funds in accordance with it.

The retainer letter excluded any advice on the supposed underlying transaction and the firm made no attempt to understand it - it simply received and distributed more than £650,000 in accordance with the terms of the 'escrow agreement'. The client told the firm that the matter involved investment in bearer bonds.

An investigation showed that there was no genuine regulated services being provided and the circumstances exhibited several of the signs from the SRA's warning notice on money laundering.

An 'investor' who lost money complained that he thought the investment must be safe because the contracts had the name of a solicitors' firm on them and he relied on the firm being the 'Paymaster'.

Our view

The law firm received and paid out money without advising on or even understanding the purported transaction. It had no real knowledge of the transaction and made no attempt to establish its legitimacy or the money's source.

In our experience, the use of 'limited retainers' of this kind is often in itself a red flag because the firm is seeking to avoid addressing the suspicious nature of the transaction. There is a clear risk here that the law firm is in breach of rule 3.3. The risks inherent in acting in this way were in fact borne out by subsequent investigation.

To act in an 'escrow' capacity a law firm must identify and understand the transaction and there must be good reason why it is the appropriate for the law firm to hold the money.

Trust administration work

A law firm administers family or other trusts, mainly for longstanding, UK-based private clients. For some of the trusts the solicitor is the trustee, in others they are acting on the trustees' instructions.

The firm's work may involve collecting trust income (for example, from investment managers and rental income generated by properties which are trust assets) and making trust payments, such as distributions to beneficiaries and payment such as school fees and trust asset maintenance payments (ie payments to surveyors), on their trustee clients' instructions, using client account.

In some cases, the firm may be instructed to carry out transactional work, using trust funds to buy or sell real estate. In other cases, the firm's role will be more administrative in nature, documenting the sale or purchase of other assets eg cars or artwork, receiving receipt of investment income and paying out trust distributions to beneficiaries (on the trustees' instructions). Firms will also arrange for the drawing up of trust accounts, using either internal or externally sourced accountancy resource.

Our view

Where the solicitors are acting as trustees (for example, as trustees under a discretionary trust, or as an executor), they will be providing a regulated professional service. In this situation, receiving trust income into client account and making payments out of it, would not give rise to a breach of rule 3.3.

The situation is different when the law firm acts for trustees, rather than as trustees. Here the firm's role is more limited to undertaking routine trust administration services, such as collecting income, preparing accounts and possibly checking the terms of the trust arrangement. On the basis that this type of work is part of the normal and longstanding regulated services of law firms, we do not consider that this type of work, of itself, will breach rule 3.3.

However, allowing clients to place what might be significant funds in a law firm's client account gives rise to risks in relation to potential money laundering or other breaches of the law. The firm will need to be fully satisfied that the arrangements are proper, and the trust is genuine. They will also need to be satisfied and able to demonstrate to us, if required, as to the legitimacy of their instructions and the source of the funds being administered.

In certain situations it may be more appropriate for the law firm to agree to operate the client's own account rather than allow its client account to

be used in this way. That does not however remove the need for firms to make sure that they are not facilitating impropriety in any way.

The situation here is also different to where a solicitor or law firm is a director of a trust corporation that is not authorised and regulated by the SRA. Money held by the trust corporation would not be subject to the SRA Accounts Rules. The solicitor directors of the trust corporation would, however, be subject to the requirement set out in paragraph 4.2 of the SRA Code of Conduct for solicitors, RELs, RFLs to safeguard money that they have been entrusted with.

Commercial rent deposits

A law firm is instructed by the landlord of a new development of commercial properties to prepare the lease agreements. The firm is also instructed to receive, and hold in client account, the rental deposits that are paid by the tenants. These will be held until the lease comes to an end and any conditions, eg dilapidations are met.

Our view

The receipt and holding of commercial rent deposits in client account would not, in itself, breach rule 3.3. This is providing that the deposit properly relates to the delivery of regulated services by the firm, such as advising the landlord, preparing and completing the lease or drafting any rent deposit deed. We expect firms to promptly release the deposit once the work has been completed. This is, of course, a requirement in the SRA Accounts Rules.

Where, for example, services are being provided relating to advice on dilapidations that arise during the term of the lease or other professional services that relate to the management of the lease, this may mean that firms retain such rent deposits in client account for some time; even until the end of the lease when the funds may be distributed according to a specified scheme or provision. Firms need to be mindful that their obligations under the SRA Accounts Rules continue for the period they hold the deposit. They will need to make sure that they, for example, keep records, account for interest and promptly return monies to the client.

We do not expect firms to be holding rent deposits indefinitely if there is no reason for the money to be held in the client account i.e. there is no delivery of regulated services, other than for the client’s convenience or because no other arrangements are feasible. This would amount to a breach of rule 3.3.

We are aware that there are some firms holding deposits which relate to leases that have been in place for a significant number of years and

include terms that a solicitor holds monies but there is no delivery of regulated services.

In these specific cases we would not expect firms to renegotiate the terms of the lease unless that was a viable option for both the client and the other parties. We consider that would be disproportionate to proactively seek to negotiate a change to the lease where there is no risk to client money and the risks highlighted in the warning notice about client insolvency and money laundering are less likely to apply in this specific scenario. If, however, there is an opportunity to change the terms of these historic leases and move money into a joint account in the name of the landlord and tenant or look at indemnity policies that would cover claims in the event of dilapidations, then firms should consider those alternatives.

A firm's reporting accountant may look for evidence of the attempts that have been made to rectify the position in respect of these historic leases.

In residential lease cases most deposits taken by landlords and letting agents must be held in one of three government-backed tenancy deposit schemes. There is therefore no reason why a law firm would need to hold residential rent deposits in their client account.

Lasting powers of attorney

A law firm is acting as attorney under a lasting power of attorney (LPA) for a client who cannot manage their own affairs due to their mental and physical incapacity. The firm is unsure whether it can hold the client’s money in their client account in order to make payments for the client’s personal living expenses or medical care.

Our view

Where solicitors are acting as attorney under an LPA (or enduring power of attorney), they act on the instructions of the donor and in the specific circumstances set out in the power of attorney. In this situation, receiving or holding the donor’s money into client account and making payments out of it, would not give rise to a breach of rule 3.3. You should always act in the best interests of your client (the donor) which may mean operating the client’s own account as signatory or placing money in a designated deposit account.

Solicitors must also comply with any other legal requirements. For example, for Court of Protection appointed deputies, the Office of the Public Guardian (OPG) has issued guidance which advises that law firms should not use client account to hold money and should instead use a designated deposit account or use the Court Funds Office account.

Lack of availability of UK banking facilities

Miss X, a potential client and newly arrived in the UK, has approached a law firm asking if it will hold monies on her behalf. She says that she does not have a UK bank account but is applying to open one. Miss X tells the firm that, although she is not instructing the firm for any legal advice at present, she will do so in the future once a business opportunity she is working on comes to fruition.

Our view

We would expect the firm to refuse to receive this money. No legal or professional services, which are regulated by us, are being provided by the firm. There is no evidence that the firm are providing any legal advice or assistance. To accept the money would be a breach of rule 3.3.

Aggregated funds

A law firm is acting for the seller (a private equity house) which is taking a leading role on the sale of a target on behalf of several other sellers. The firm collates all the funds due from the buyer on completion and holds these in its client account. Following completion, the firm pays the money to their client (the seller) and to the other represented or unrepresented sellers (subject to carrying out due diligence checks).

Our view

The funds received on behalf of, and paid out to, the client for which the law firm is acting (the lead seller) would not breach rule 3.3. The funds belong to that client and are received in connection with the regulated services which the firm is providing.

However, receiving money into client account, from or on behalf of, and to be paid to the other sellers does raise risks of a breach of rule 3.3. The law firm will need to be satisfied that there is a proper reason for these funds to be received into client account (for example, to facilitate completion of the sale and purchase of the assets, and that would not be feasible if the firm could not act in this way).

Collation of investment funds

A law firm acts for one of several debt or equity investors involved in acquiring a target investment. The firm is instructed to receive the aggregate collated investment funds into its client account. This is so that one firm is responsible, in accordance with an undertaking to be given, to complete the proposed investment out of hours. The completion of the investment is not subject to formalities which need specifically to be checked by a solicitor.

If the payments were to be made piecemeal (from the various represented and unrepresented investors) into a target investment, none

of the investors (including the solicitors' client) would have comfort that the full amount of the investment would be invested, and the deal could be lost if there was no ability to complete and make payments out of hours.

Our view

The funds received from the client for which the law firm is acting (the lead investor) would not breach rule 3.3. The funds are that client's money and are received in connection with a transaction on which the law firm is advising, and therefore form part of the firm's regulated services.

However, receiving other money into client account, from or on behalf of, the other investors – who the firm is not acting for - does raise risks of a breach of a rule 3.3. The law firm will need to be satisfied that there is a proper reason for these funds to be received into client account. In this instance, there is a risk that the transaction would not be completed without one firm taking control and receiving into its client account the investment funds – and being able to complete out of hours and to give the necessary and appropriate undertakings.

The law firm needs to understand the nature and propriety of the underlying transaction and the source of any funds received. There are clear risks of being involved in money laundering when non-client funds are received into a firm's client account and then paid out.

Lender's condition on mortgage offer

A firm is instructed to act for a lender and borrower in connection with a remortgage. One of the conditions of the mortgage requires the firm to pay off certain debts and credit card balances owed by the borrower before the balance is released to them.

Our view

These payments are a condition of completing the transaction and as such is part of the regulated services provided by the firm to the lender and borrower. It would not in our view breach rule 3.3, provided the condition clearly details the specific debts to be cleared.

'Legal advice only' retainers

A firm is instructed to provide specialist tax advice in relation to the payment of SDLT [stamp duty] on a property which has been bought by the client. The firm did not act in the purchase but the client wants to forward the tax payable to the firm with a view to the firm paying the sum on their behalf.

Our view

This is likely to be a breach of rule 3.3 if there is no reason for the firm to hold monies.

Our warning notice [see above] makes it clear that simply having a retainer with the client is not sufficient reason to accept the money - the firm must be satisfied that there is a proper and justifiable reason why the money should pass through their client account rather than be paid direct by the client. In this case, the firm's retainer was limited to providing stand-alone legal advice. The firm did not act in the purchase and there is no obvious reason for them to receive the money rather than the client paying direct.

Sale of the matrimonial home as part of divorce proceedings

A firm is acting for a husband and wife in connection with the sale of the former matrimonial home. The clients are in the process of a divorce and separate firms act for each of them in respect of their financial affairs. The sale of the property has completed but the net proceeds of sale have not been distributed as the parties have not yet reached an agreement as to the division of the sale proceeds.

The solicitor is concerned that if he does not pay the money out promptly he will be in breach of rule 3.3.

In some cases the solicitor may also be asked to settle a debt to a third party from the net proceeds of sale - eg, settle a backlog of school fees for their child.

Our view

In a joint retainer a firm cannot pay out any of the net proceeds of sale without the joint agreement of both clients. If the firm is unable to obtain their joint instructions then they must continue to hold the money until the clients reach agreement or there is a court order.

Consequently, the firm will not be in breach of rule 3.3 since there is a proper reason for them to continue holding the money.

However, if as in this case the parties have other solicitors acting for them in the financial settlement it may be possible to arrange for one of those firms to hold the money in place of this firm if those firms can agree an appropriate undertaking.

Since the money forms part of the matrimonial assets we do not think it would be a breach of rule 3.3 for this firm to send the net proceeds of sale to one of the firms acting in the divorce settlement.

As regards paying a debt out of the proceeds of sale to a third party, if there is a court order requiring the payment to be made then there will be no issue under rule 3.3.

In the absence of a court order our view is that this is all part of sorting the clients' matrimonial affairs because of the divorce proceedings. In these limited circumstances we would not therefore consider it to be a breach of rule 3.3. We would expect you to be mindful of your professional obligations and make sure that:

- the payment is in respect of an existing debt which would be taken into account in the resolution of the ancillary proceedings
- the firm has the written consent of both of their respective solicitors
- the firm is satisfied that this is not an insolvency situation risking the preferential treatment of one creditor over others.

Parent paying child's legal fees

The firm acted for a client in the sale of commercial premises. The transaction has been completed and the firm are in the process of accounting to him for the net proceeds of sale. Independently of this retainer, the client's son has instructed another solicitor in the firm to act for him in buying a flat.

The father has asked the firm to retain enough money to cover his son's legal fees and to send the balance to him. The firm are concerned that by transferring the money to the son they may be in breach of rule 3.3.

Our view

Provided the firm has clear instructions from the client and the firm is satisfied that the payment to be retained is only for their fees and there are no other red flags as outlined in our warning notice our view is that this will not be a breach of rule 3.3.

Conveyancing and retentions

It is not uncommon for part of the purchase price to be retained by the buyer's solicitor until such time as an outstanding issue has been resolved. Examples of this include where the seller has agreed to carry out some work or is awaiting details of the annual service charge on the property, or in a new development, to ensure the developer deals with a snagging list or the local authority adopts the road.

Our view

Until the issue has been resolved and the balance of the money has been paid to the seller's solicitor the retainer has not been completed.

In most cases, it will not be necessary for the firm to hold the money for very long but where the retention is in respect of a road being adopted, this can take a significant length of time.

In these cases, it is advisable for the solicitor to make sure that the need for the retention is reviewed on a regular basis so that funds are not held for longer than necessary.