Client Money Digest

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HAT
Group of Accountants

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PROPOSED AMENDMENTS TO SRA ACCOUNTS RULES

The Solicitors Regulation Authority ("SRA") has completed a post-implementation review of the SRA Accounts Rules which came into force on 25 November 2019. Their Press Release advises:

"Since their implementation, we have identified areas of the new rules which are causing some practical difficulties either for firms or operationally for the SRA. We identified these areas through engagement with and feedback from external stakeholders and through our one-year evaluation of the Standards and Regulations.

In some instances, we have found that the original policy intention is not being met by the rules. In others, the wording in our rules needs further clarification to achieve the intended outcome. In a number of cases, we have already clarified our position, for example, through guidance and waivers for specific rules granted to individual firms."

The SRA is now proposing to make minor amendments to the SRA Accounts Rules to address these issues. In response to feedback which has been received in respect of the SRA Accounts Rules, there are three proposed amendments, which are explained in the SRA's consultation document as follows:

"Amendment 1: Firms taking money for costs in advance of work being done:

Law firms have told us it is unclear when it would be appropriate to take client money for anticipated costs from their client account into their business account.

The current wording of the rules does not prevent firms from sending a bill and then transferring money from their client account for their anticipated fees (in advance of work being done or for future disbursements not yet incurred.)

This would result in the client's money losing the protection that it would otherwise have had if held in a client account. To help law firms and reporting accountants we issued guidance outlining how firms could satisfy our requirements.

What we are changing:

We are now consulting on proposed changes in Rule 2.1 (d). We hope this will make it clear that, in order to transfer funds from client account into the firm's business account, the bill, or other written notification of costs, must be for costs that have already been incurred. The proposed amendment can be seen in Annex 1.

Amendment 2: Reimbursements for money spent on behalf of the client:

Firms have asked us whether they need to deliver a bill or written notification of costs incurred before they move money from their client account and reimburse themselves for disbursements which have already been paid on behalf of the client. For example, where the firm has paid for Land Registry search or court fees using their own money (often by a direct debit from the firm's business account).

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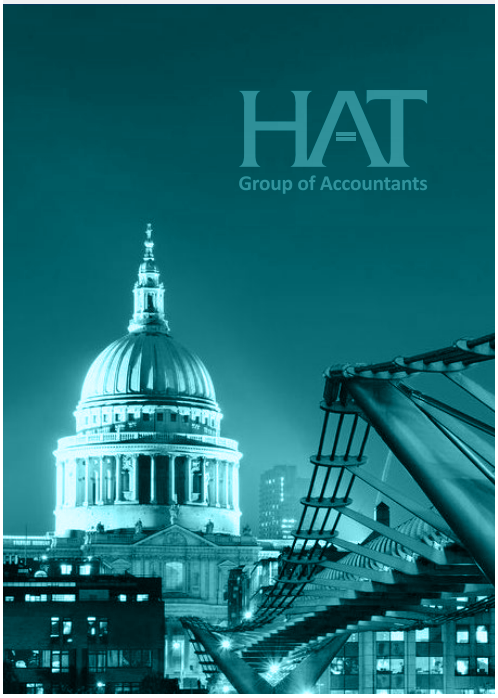

In our guidance we are clear that the client must understand how their money will be used and have confirmed their instructions. If so, we see no risks to the client in transferring money into the firm's business account for disbursements that have already been paid on their behalf. This can be without a bill being issued first.

What we are changing:

Our proposed rule changes make it clear that in the circumstances above there is no requirement to deliver a bill or written notification of costs before moving money from the client account. This can be in full or partial reimbursement of money spent by the firm on behalf of the client. The proposed amendment can be seen in Annex 1.

Amendment 3: Operating a client's own account:

Law firms and individual solicitors can operate a bank or building society account that belongs to their client. For example, when a solicitor has been appointed as a deputy (Court of Protection) or attorney (under a power of attorney). We call this operating a client's own account. This enables solicitors to make and / or receive payments directly from / into that account and means there is no need for the client's money to be transferred into the law firm's client account.

Since we introduced the new rules, firms operating a client's own account have reported difficulty in implementing our requirements (which match those for law firm client accounts). These are set out in Rule 10.1 (a) and (b) and mean they must reconcile client accounts every five weeks and obtain bank statements.

We introduced the rules to recognise where solicitors have access to a client's own personal bank account the risk to that client's money being misused is greater. Those clients are also more likely to be vulnerable and may be unable to self-advocate.

We have heard from many firms that it is often not possible to access monthly bank statements to an account belonging to a client which they control. In response, we issued guidance on how to satisfy our requirements without increasing the risk to the client.

What we are changing:

We now propose to amend Rule 10.1 (a) and (b) in order to make the arrangements workable so that firms must:

- Undertake reconciliations every 16 weeks;
- Maintain a central register of clients' own accounts under control of the firm; and
- Keep records of transactions carried out by the firm on behalf of the client and record bills and other notification of costs relating to the client's matter.

The proposed amendment can be seen in Annex 1."

The SRA consultation closes on 8 March 2023.

HAT RESPONSE
Once amendments have been finalised by the SRA, time will be set aside to update the HAT SRA Accounts Rules methodology.

REGULATORY IMPACT OF INCREASING INTEREST RATES

After an extended period of very low interest rates in the UK, the ICAEW's Solicitors' Community has highlighted the impact that increasing interest rates will have on the practical application of the SRA Accounts Rules and their article states:

"Law firms have an extra issue to address when it comes to rising interest rates – Rule 7 of the SRA Accounts Rule 2019. Rule 7.1 states, "you account to clients or third parties for a fair sum of interest on any client money held by you on their behalf". The key words in this sentence are "fair sum". In recent years, interest rates have been so low that these words never needed to be dissected. In fact, it was little over a year ago that the possibility of negative interest rates became a real possibility, and some banks were considering charging law firms for holding funds.

Many firms will have a de minimis amount below which interest will not be paid to clients. This is normally detailed in the client care letter or terms of engagement. This should be reviewed regularly to ensure it remains "fair". In addition, accounting systems must have controls in place which calculate when interest becomes payable to clients. If this is not the case, there is a breakdown in the control mechanism and the client might not receive the interest they are owed.

Rule 7.2 does offer a degree of flexibility by stating, "you may by a written agreement come to a different arrangement with the client or the third party for whom the money is held as to the payment of interest, but you must provide sufficient information to enable them to give informed consent". The real test here is ensuring there is, "sufficient information" in order for a decision to be made.

One point to consider as reporting accountants is that Rule 7 is not one of the rules we need to carry out work on. However, if we come across a firm where their interest policy or accounting for interest is not in line of Rule 7, we should consider the overall impact. Where interest should be paid to a client and no such payment is made, client money may be being incorrectly held in the business account."

ACTION FOR FIRMS
When undertaking procedures to produce an Accountant's Report, ensure you consider if interest on client money is correctly dealt with.

FINANCIAL SERVICES AND MARKETS BILL

HM Treasury has published the Financial Services and Markets Bill (along with explanatory notes) as introduced to Parliament on 20 July 2022. Its Press Release states:

"The Bill seizes the opportunities of EU Exit, tailoring financial services regulation to UK markets to bolster the competitiveness of the UK as a global financial centre and deliver better outcomes for consumers and businesses. The Bill will:

- Implement the outcomes of the Future Regulatory Framework (FRF) Review;
- Maintain the UK's position as an open and global financial hub;
- Harness the opportunities of innovative technologies in financial services;
- Bolster the competitiveness of UK markets and promote the effective use of capital; and
- Support the levelling up agenda, promote financial inclusion and consumer protection."

The Bill has now completed its Commons Committee stage and a current commentary regarding the Bill's status and changes which have been made is available on the UK Parliament's website.

In particular, reasons for the "Brexit" changes are explained as follows:

"The UK is currently undergoing changes in the regulation of financial services. In October 2020, the Treasury consulted on the Future Regulatory Framework for financial services to consider how to adapt regulation to reflect the UK's new position outside of the EU. A further consultation was issued in November 2021. The Treasury responded to that consultation alongside the Bill's publication in July 2022. Many of the Bill's measures seek to implement measures consulted on as part of this review.

As an EU Member State, the UK applied hundreds of pieces of EU financial services legislation. When the UK left the EU Single Market, much of this legislation was "onshored" (preserved in domestic law) as "retained EU law". The Government believes that, for the most part, issues dealt with by retained EU law would best be dealt with by UK regulators – mainly the Financial Conduct Authority ("FCA") and the Prudential Regulation Authority ("PRA") – exercising their own rule-making powers."

In addition, a new clause will bring cryptoassets within the scope of regulation for the first time and will ensure that the Treasury is equipped to respond to developments in the crypto sector more quickly and deliver regulation in an agile, risk-based way.

It is currently expected that Royal Assent will be granted in the spring of 2023.

HAT RESPONSE
Where changes are made to the FCA Client Assets Sourcebook, time will be allocated to amend the HAT FCA Client Assets Reports methodology.

FCA UPDATE ON CLAIMS MANAGEMENT COMPANIES

The FCA has published a letter setting out its ongoing strategy for the supervision of claims management companies (CMCs). In the letter, the FCA explains that while CMCs have made improvements in some areas since a previous letter sent in October 2020, there are remaining, as well as new risks that they must address. The following are extracts from the FCA's letter:

"The FCA's view of the drivers of harm and risks that CMCs pose to their consumers or the markets in which they operate:

We recently created new rules to restrict the fees CMCs charge through a fee cap and introduced new rules banning CMC 'phoenixing' so that individuals responsible for financial services failings cannot subsequently set-up CMCs to bring claims to the Financial Services Compensation Scheme.

CMCs also need to start preparing for the implementation of our Consumer Duty, which comes into force on 31 July 2023. It will set a higher standard of care that firms should provide to consumers in retail financial markets. Amongst other things, it will require firms to focus on supporting their customers to make good financial decisions (including those in vulnerable circumstances) and avoid / avoiding causing foreseeable harm and checking whether their customers are getting good outcomes. This includes providing information consumers can understand, products and services that are fit for purpose and offer fair value and helpful customer service.

The FCA's expectation of CMCs, including how firms should be mitigating these key risks:

Although we have seen improvements across the CMC industry, our analysis has highlighted the following residual concerns:

- Misleading, unclear and unfair advertising;
- CMCs using their FCA authorisation to legitimise their non-regulated services;
- Inappropriate sourcing of customers;
- Firms failing to investigate the existence and merits of each element of a potential claim; and
- Poor attitude to regulatory obligations.

As a result of the multi-firm work we conducted in the last period, we also identified some examples of poor complaint handling and an inability to identify vulnerable customers.

The FCA's supervisory strategy and programme of work to ensure that firms are meeting our expectations, and harms are being remedied and / or mitigated:

In consideration of our organisational Strategy and Business Plan, we will focus our strategy for CMCs on the following areas:

- CMCs conducting both unregulated and regulated activities;
- CMCs using lead generators; and
- Service standards.

Next steps:

We expect firms to take notice of the areas of concern and the expectations we have set out in this letter and discuss this at board level or other appropriate governing body, if appropriate, in order to consider whether you can make changes to reduce any harm or potential harm to consumers.

Whatever the size of your firm, you should have appropriate governance and systems and controls for the nature, scale and complexity of your business. If we contact you, we will expect you to be able to demonstrate this and your wider actions to protect consumers from harm. If you cannot do this, we will take steps to address any weaknesses we identify. In particular, we will act where we find that CMCs do not put their customers at the heart of how they do business, for example where they have put their own profits and income above consumers' interests and fair treatment."

Note that regarding the new Consumer Duty, the FCA is sending tailored communication to each regulated sector outlining these new requirements and has published a range of podcasts, which are available on the Consumer Duty home page.

ACTION FOR FIRMS
When undertaking procedures to produce an Accountant's Report, ensure you consider if interest on client money is correctly dealt with.

"THE EDINBURGH REFORMS"

During a speech made in Edinburgh (hence the "Edinburgh Reforms") in December 2022, the Chancellor of the Exchequer (Jeremy Hunt) announced a number of reforms of financial services, with the following being included in the subsequent Press Release:

"The Chancellor will set out plans to repeal, and replace, hundreds of pages of burdensome EU retained laws governing financial services. This will establish a smarter regulatory framework for the UK that, is agile, less costly and more responsive to emerging trends.

These plans included a commitment to make substantial legislative progress over the course of 2023 on repealing and replacing EU-era Solvency II – the rules governing insurers balance sheets, which is expected to unlock over £100 billion of private investment for productive assets such as UK infrastructure.

The Edinburgh Reforms seize on our Brexit freedoms to deliver an agile and home-grown regulatory regime that works in the interest of British people and our businesses.

A competitive marketplace promoting the effective use of capital:

The Edinburgh Reforms ensure that the UK's financial markets are among the most open and attractive in the world. They deliver this by overhauling the UK prospectus regime to make it more attractive for firms to list and raise capital here; reforming the rules governing Real Estate Investment Trusts, to reduce friction and allow savers to more easily access higher returns; formally reviewing the provision of investment research in the UK, including the effects of the EU's MiFID unbundling rules, which aren't applied in leading markets such as the US; and working with the regulators and companies to trial a new class of wholesale market venue that operates on an intermittent basis – improving companies access to capital before they publicly list.

The Chancellor has also issued new remit letters to the FCA and PRA emphasising the new secondary competitiveness objectives. Regulators will have a duty to facilitate, subject to aligning with relevant international standards, the international competitiveness of the UK economy and its growth in the medium to long term.

Delivering for consumers:

The government is committed to enabling consumers to access the benefits of new products and technologies, while ensuring they remain protected. To support this, the government has published its first consultation on proposals to modernise the Consumer Credit Act – simplifying the regime to encourage innovation in the credit sector and cutting costs for consumers and businesses.

A sector at the forefront of innovation and technology:

The reforms build on the UK's desire to harness the benefits of emerging technologies, including committing to shortly publish a consultation on proposals to establish a UK Central Bank Digital Currency – which could one day see Brits using a digital pound. Other measures will see the Investment Management Exemption extended to cryptoassets, ensuring more overseas investment can flow into the sector.

More broadly, the government's Financial Services and Markets Bill has successfully completed its remaining stages in the Commons and is expected to receive Royal Assent by Spring 2023. This further delivers on the government's vision for financial services, including by bringing certain types of stablecoins within the payments regulatory perimeter; protecting access to cash for millions of people that rely on it; and enabling the Payments Systems Regulator to force banks to reimburse the victims of Authorised Push Payment (APP) fraud."

Further to the above, HM Treasury has announced a three month consultation until the end of April 2023 proposing to regulate certain digital assets and its Press Release states:

"Under plans set out by the government, it will seek to regulate a broad suite of cryptoasset activities, consistent with its approach to traditional finance. These proposals will place responsibility on crypto trading venues for defining the detailed content requirements for admission and disclosure documents – ensuring crypto exchanges have fair and robust standards.

The proposals will also strengthen the rules around financial intermediaries and custodians – which have responsibility for facilitating transactions and safely storing customer assets. These steps will help to deliver a robust world-first regime strengthening rules around the lending of cryptoassets, whilst enhancing consumer protection and the operational resilience of firms. As part of this approach, the consultation will seek views on improving market integrity and consumer protection by setting out a proposed crypto market abuse regime.

In addition, to address industry concerns about the small number of FCA authorised cryptoasset firms who can issue their own promotions, HM Treasury is also introducing a time limited exemption. Cryptoasset businesses that are registered with the FCA for anti-money laundering purposes will be allowed to issue their own promotions, while the broader cryptoasset regulatory regime is being introduced.

This approach delivers on the original policy intention of the measure to promote innovation, enhance consumer protection and ensure that cryptoasset promotions can be held to equivalent standards as promotions of financial services products with similar risk profiles."

HAT COURSE DATES

To ensure that all members of your team who deal with assurance assignments in respect of client money are fully trained, HAT will be running the following CPD courses:

- SRA Accounts Rules in Practice – A Guide for Reporting Accountants ~ Tuesday 28 March 2023; and
- Introduction to SRA Accounts Rules Assignments ~ Tuesday 18 April 2023.

These CPD courses will be running online, or may alternatively be run, "in-house" for a firm on a mutually convenient date during 2023.

Additionally, it is possible for CPD courses relating to Service Charges, Property Agents' Client Money, and Insurance Brokers' Client Money to be provided, subject to demand.

For details of our charges and availability, please contact Roger Morris at the HAT Office at roger@hatgroup.co.uk.

HAT ASSURANCE METHODOLOGIES

There have been no amendments to any of the HAT documentation covering client money assignments in the last year. Such documentation covers:

- FCA Client Assets Reports;
- SRA Accounts Rules Accountants' Reports; and
- Property Agents Client Money Assignments.

When performing an assignment to provide an Accountant's Report to Propertymark, it should be noted that there have been cosmetic amendments during 2022 to both the rules and the Accountant's Report. A detailed review has been performed and no amendment is required to the HAT Property Agents Client Money methodology.

ACTION FOR FIRMS
When completing a Propertymark Accountant's Report, ensure that the updated pro-forma report is utilised.

Additionally, it should be noted that, following the introduction of ISQM (UK) 1, where an engagement quality review ("EQR") is performed on a reasonable assurance assignment on a Large / Medium CASS investment business firm, this should be performed in accordance with the enhanced requirements of ISQM (UK) 2.

ACTION FOR FIRMS
Note that other than when an EQR is mandatory, a hot review does not need to be performed in accordance with ISQM (UK) 2.

IMPORTANT NOTE

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