

SRA consultation on client money in legal services: Shieldpay's response

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Executive summary

- The subject of client money in legal services is highly emotive. There is a broad consensus amongst firms, which strive to comply with the spirit and letter of the existing framework, that they are being tarred with the same brush as Axiom Ince, Metamorph, SSB and other high-profile failures; that if the SRA pursues its “*longer term ambition to stop firms from holding client money*”, this will have an emasculating effect on the profession and immutably damage its brand image.
- Ultimately, the ‘client money question’ may be reduced to one of ethics and professional conduct. So long as there are those within the profession who are inclined towards dishonesty, or become dishonest in consequence of their individual circumstances, there will be scope for consumer harm.
- As a regulator, the SRA is charged with responsibility both for ensuring that the conditions that may permit dishonest conduct to occur are minimised in the short term, and to ensure that there are proper systems and controls in place to protect consumers in the long term.
- The consultation presents a unique opportunity for the regulator and the regulated to ask themselves a bigger question: just because firms *can* hold client money, does it mean that they *should*? The requirement for firms to hold client money in a separate account was introduced almost a century ago following a string of high-profile client money misappropriations¹ and yet, after several developmental phases in client account regulation, the profession finds itself back in the same place.
- While the threats facing firms have changed significantly in that time, so too has the payment landscape and capabilities of providers that are able to help firms face down those threats and, in turn, ensure that consumers are adequately protected.
- It is our view that the SRA's longer term ambition to stop firms holding client money is the right one. Through developments in payment systems such as RTGS, property-specific settlement solutions leveraging those payment systems, synchronisation initiatives, and escrow, paying agent, and payment account solutions being offered by payment services providers such as Shieldpay, the availability of viable alternatives is expanding rapidly.
- Of course, bringing about transformation of this scale cannot happen overnight. In third party managed accounts (**TPMAs**), the SRA has already attempted to provide firms with an alternative that offers a significant regulatory advantage. Yet the uptake of TPMAs has been slow, and attitudes towards them vary significantly. We have identified that this is perhaps due to the need for firms to ‘handle’ client money being conflated with a requirement for firms to ‘hold’ client money; leading to several misconceptions about what TPMAs are, and how they function.

¹ Lunney M. *The law society and the defalcation scandals of 1900* Legal History, Vol. 17, No. 3 (December 1996), pgs. 244-269

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- We maintain that, at a basic level, TPMA's are not that different from client accounts: the distinguishing factor is that funds are held in safeguarded accounts with a bank in the name of an FCA-regulated payment institution rather than in the name of a law firm, taking the holding of those funds outside the SRA's regulatory purview. Choosing between a client account and a TPMA does not mean choosing between the effective *handling* of client money in the context of the services provided by firms.
- We have received an increasing number of enquiries from firms wanting to operate a TPMA in parallel with their client account, rather than going 'all in' with TPMA. This is typically because firms have a concern that they may breach the banking facility rule by receiving and holding funds in connection with a specific matter, or because their risk appetite has changed, such that they no longer want to process payments over a certain value threshold or number of payees via their client accounts. It would be helpful if the SRA's guidance on TPMA's made it clear that this is permitted, provided clients and third parties are informed about how their money is being held.
- While there can be no guarantee of 'perfect trust' with any alternative, TPMA's introduce an additional layer of accountability and transparency and, in turn, increase trust and confidence by: (a) enabling firms to provide clients with real-time visibility of payment transactions at matter level; and (b) leveraging impartial, purpose-specific, and strictly regulated payment service providers. It is our view that firms can remain competitive, deliver value and even enhance the value given to their clients, without them continuing to hold client money.

Introduction

1. Shieldpay Ltd is authorised and regulated by the FCA as an authorised payment institution under the Payment Services Regulations 2017 (**PSR 2017**). Those regulations, combined with other FCA standards and guidance, establish prescriptive rules for providing payment services, with payment institutions also being subject to the FCA Principles for Businesses², which are not dissimilar to those framed within the SRA Principles³.
2. We have specific experience and expertise in facilitating payments within the UK legal industry, specialising in delivering seamless, compliant, payment journeys for a range of firms and practice areas. Since 2016, we have facilitated over £11 billion of payments for the legal industry through our escrow agent, paying agent, mass disbursement and TPMA services.
3. As a leading provider of TPMA services since they were first introduced, we have often been at the fulcrum of the debate on client money. Over the past year at roundtable events, at the SRA Compliance Officers' Conference 2024, and in several other forums, we have spoken with senior personnel responsible for overseeing the handling of client money. The views expressed by them have ranged from anger, frustration and hostility towards the very notion that firms should not hold client money; to an acceptance that the way firms handle client money and adoption of suitable alternatives is necessary and even beneficial for firms, consumers and the profession as a whole.
4. While the debate over client money might appear to be a recent fixation triggered by Axiom Ince, it is a debate almost as old as the regulation of solicitors itself. In a 2009 paper by two academics from the Universities of Bristol and Cardiff⁴, which considered the evolution of accounting regulations within the legal profession, the authors note that: "An analysis of the historical development of the financial regulation governing legal practitioners produces evidence which suggests that the dominant motive for introducing financial regulations was the need to be seen to respond to political pressures and threats."⁵ While the world and the threats posed to firms and their clients have changed significantly since the 19th century, in many ways this still holds true⁶.

² Financial Conduct Authority, *Principles for Businesses, PRIN 2.1*, Effective 31 July 2023
<https://www.handbook.fca.org.uk/handbook/PRIN/2/1.html>

³ Solicitors Regulation Authority, *SRA Principles*, Effective 25 November 2019
<https://www.sra.org.uk/solicitors/standards-regulations/principles/>

⁴ Roy A. Chandler & Nadine Fry, *Regulating a reluctant profession: Holding solicitors to account*, *Accounting Forum*, Taylor & Francis Journals, vol. 32(4), pgs. 303-312, December 2008

⁵ *Ibid*, pg. 304

⁶ The matter of Axiom Ince has been raised twice in Parliament: see HC Deb 756 col 903 (14 November 2024) <https://hansard.parliament.uk/Commons/2024-11-14/debates/B31846D9-FD53-4AF8-8F67-84A2657B56F1/SeriousFraudOffice> and HC Deb 753 col 690 (10 September 2024) <https://hansard.parliament.uk/Commons/2024-09-10/debates/A77A1470-E455-483E-BC79-A5F1A97246D3/TopicalQuestions>

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5. However, in the context of the historical analysis set out in that paper, the profession has undoubtedly come a long way in its acceptance of the need for a robust regulatory framework for the protection of client money. Indeed, during a plenary session on client money at the SRA Compliance Officers' Conference 2024, an impassioned demand for a return to a more prescriptive set of rules was met with rapturous applause.
6. That applause was perhaps telling in two ways:
 - (a) it implied that a return to a more prescriptive set of rules akin to the Accounts Rules 2011 may have prevented Axiom Ince from occurring in the first place. However, the independent review of events leading up to the SRA's intervention into Axiom Ince⁷ identified that the "light touch" approach to the ongoing regulation of solicitors' accounts generally, and the insufficiency of controls relating to accountant's reports specifically, needs to be addressed⁸. These were contributing factors which indirectly enabled Axiom Ince's owner and managing director, and certain other directors, to misappropriate client money on a large scale without detection; and
 - (b) it was a demonstration of just how concerned attendees were at the viability of alternatives to client accounts that they would be willing to accept the administrative burden, compliance risks, and corresponding cost consequences that would inevitably follow more prescriptive and restrictive rules.
7. In Shieldpay's response to the SRA's discussion paper '*Protecting the public: our consumer protection review*'⁹ (**Discussion Paper**), we urged the SRA to consider the wider challenges of handling client money, not just the risk of 'bad actors', to ensure that the consultation process surfaced the benefits of alternatives for firms and consumers alike.
8. Shieldpay now offers its response to the consultation on client money in legal services. As the consultation questions are directed towards regulated firms of solicitors (referred to as **firms** throughout) rather than service providers, this response has been published on Shieldpay's website and provided directly to the SRA for its consideration.
9. Our response is focussed on Part 1 (The model of solicitors holding client money), as this is most relevant to Shieldpay as a provider of TPMA services.
10. We have not responded to Part 2 (Protecting the client money that solicitors hold), having expressed our views on other measures that the SRA may consider for enhancing consumer protection in our response to the Discussion Paper¹⁰.

⁷ Carson McDowell LLP, *Independent Review of the Regulatory Events leading up to the Solicitors Regulation Authority's Intervention into Axiom Ince Limited*, 21 October 2024
<https://legalservicesboard.org.uk/wp-content/uploads/2024/10/Independent-Review-of-the-Regulatory-Events-Leading-up-to-the-SRAs-Intervention-into-Axiom-Ince-Lim.pdf>

⁸ *Ibid*, paras 36-40 with reference to the analysis at pgs. 252-283

⁹ Shieldpay, *SRA Consumer Protection Review: Shieldpay Response to Discussion Paper*, 27 June 2024
<https://www.shieldpay.com/third-party-managed-accounts/sra-consumer-protection-review-response>

¹⁰ *Ibid*, para 32

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11. In respect of Part 3 (Delivering and paying for a sustainable compensation fund), we share the SRA's view that the compensation fund plays a crucial role in maintaining public trust and confidence in legal services and that if solicitors are permitted to hold client money, the integrity of the fund must be preserved.
12. However, the great paradox is that while the profession is keen to retain the perceived sense of control and market advantage that comes with operating a client account, it bemoans the corresponding, and sharply increasing, costs of maintaining the compensation fund at the level necessary to meet the shortfall created by Axiom Ince, and to fund any future significant claims for client money loss. The cost of maintaining a sustainable fund therefore needs to be factored into the SRA's regulatory impact assessment, firms' evaluation of the costs of continuing to rely on client accounts as the primary means of holding client money, and an understanding of how those costs are currently being passed on, at least in part, to consumers.

The holding of client money generally

13. The subject of client money in legal services is highly emotive. Many firms, especially those with significant conveyancing and probate practices, consider the handling of client money to fulfil an 'essential function' in delivering legal services, rather than something which is ancillary to it. This view is supported by the Law Society whose president remarked: *"The ability to handle client money is an important difference between solicitors as regulated professionals and unregulated services providers. Client accounts are a fundamental tool for the efficient and effective delivery of many types of legal services."*¹¹
14. Accordingly, removing the ability for firms to hold client money is perceived to be subtractive in two main ways:
 - (a) The 'market competition argument' maintains that removing the ability for firms to hold client money threatens the market position of those firms in an increasingly open market for legal services, as brought about by the Legal Services Act 2007. However, as highlighted by a legal services market study conducted by the Competition and Markets Authority in 2016¹², the holding of client money is not itself a 'reserved legal activity', but rather a product of 'title-based' or 'during-the-event' regulation', which brings the holding of client money within the purview of frontline regulators¹³.

¹¹ The Law Society, 1 July 2024, SRA consumer protection review: client accounts vital for legal services <https://www.lawsociety.org.uk/contact-or-visit-us/press-office/press-releases/sra-consumer-protection-review-client-accounts-vital-for-legal-services>

¹² CMA, *Legal Services Market Study, Final Report*, 15 December 2016, paras 5.77-5.78 <https://www.gov.uk/cma-cases/legal-services-market-study>

¹³ Mayson S., *Independent Review of Legal Services Regulation, Working Paper LSR-2*, March 2020 https://www.ucl.ac.uk/ethics-law/sites/ethics_law/files/irlsr_wp_lsr-2_scope_final.pdf

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If there were serious concerns about unregulated providers holding client money and placing consumers at risk, then this is a regulatory gap which would need to be closed. At the same time, this regulatory gap does not give unregulated providers free rein to hold client money: they must either partner with a provider holding the necessary regulatory permissions to provide payment services or obtain the necessary regulatory permissions for holding 'client assets' under Part 4A of the Financial Services and Markets Act 2000.

Given the complexity, cost and time of obtaining authorisation from the FCA, not to mention the ongoing compliance burden, it seems unlikely that an unregulated service provider, intent on providing legal services free from the constraints of SRA regulation, would seek to bring itself within the FCA's regulatory perimeter solely for the purpose of executing transactions for its clients. As such, it cannot rightly be said that there is any regulatory disadvantage for firms, or regulatory advantage or gain for unregulated service providers, in consequence of firms being prevented from holding client money.

- (b) The 'efficiency argument' maintains that the value firms can offer to clients will be significantly impaired if they are no longer able to efficiently facilitate payments in the context of matters on which they have provided regulated legal and professional services (being the only circumstances in which the 'banking facility rule', as set out in rule 3.3 of the Accounts Rules, permits a client account to be used).

In this regard we would make the following observations:

- (i) The efficiency argument is perhaps reflective of the 'power drill mentality' referenced in *Future of the Professions*¹⁴, whereby professionals tend to fixate on what it is they do today and how they might do that thing quicker, cheaper, or better, rather than the more fundamental question of what is the 'hole in the wall', which is to say, consumers do not engage firms because of the perceived efficiency with which *payments* may be made (this is, or should be, purely functional), but rather the *knowledge* that professionals hold. The combination of this knowledge with an ability to apply and convey it in a way that delivers the best outcomes for consumers, having regard to their individual needs, should be the focus¹⁵.

¹⁴ Susskind D., Susskind R., *The Future of the Professions*, 2015, Oxford University Press

¹⁵ In this context, "*best outcomes*" can mean a variety of things: speed of execution, quality of service delivery, empathy and counselling, elimination or mitigation of legal or other risks, achievement of specific goals, or avoidance of specific outcomes.

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The *Future of the Professions* observes how professional work is evolving with increasing velocity. In as little as a decade or two, the professional landscape could look very different from today. In the legal industry this will happen both as a product of deregulation¹⁶, changing consumer expectations, technological developments, and the 'decomposition' of legal work into its constituent elements, inviting a detailed analysis of the necessity for and efficiency of each element. The holding of client money should form part of such analysis.

- (ii) Conveyancing-only firms and firms with substantial conveyancing practices are perhaps the most outspoken in terms of the efficiency argument. Below, we examine each of the key elements of this argument and how, in relation to TPMA's, those arguments do not hold up.

In any case, the client money debate should not be considered primarily through the prism of conveyancing. Several innovations are being explored which may render moot the question of firms holding client money in relation to conveyancing. These include developments in the Bank of England's real time gross settlement (RTGS) scheme which will go live in Spring 2025¹⁷, industry adoption of property-specific settlement solutions that leverage that scheme, and synchronisation initiatives. The development of the policy and regulatory framework around distributed ledger technology and digital asset registers, stablecoins, and the 'digital pound', is also likely to usher in significant changes in the way conveyancing payments are settled in future.

- (iii) While the misappropriation of client money is nothing new, it is becoming increasingly uncomfortable for the profession to justify the holding of client money on efficiency grounds.

The profession's 'defensive moat' against consumer intolerance, reinforced through a combination of statutory reservations and title-based regulation, risks being breached if the SRA is unable to identify, intervene, and prevent further high-profile cases from emerging in the future. But such regulatory oversight comes at a cost which will, invariably, be passed onto consumers.

- 15. The market competition and efficiency arguments in favour of firms holding client money are not mutuality exclusive. However, it is important to explore what the profession really means when it refers to 'holding' client money.

¹⁶ Consider further the CMA market study (*Ibid.*, paras 35-38) which pre-dated changes permitting unregulated legal services providers from employing regulated solicitors to undertake non-reserved legal activities, and the concern expressed by the CMA at the time that the definition of 'reserved legal activity' may need to be re-examined, with a view to aligning consumer protection and risk with consumer choice.

¹⁷ Bank of England, *RTGS Renewal Programme*, Last updated 24 October 2024
<https://www.bankofengland.co.uk/payment-and-settlement/rtgs-renewal-programme>

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16. The client account – being nothing more than an interest-bearing bank account held in a firm's name – has become a proxy for *handling* client money in general terms. Firms consider that a client account gives them 'control' over client money in three main ways:

(a) Control over balances

Firms consider that a client account offers certainty as to where client money is held at any point in time, such that client account balances are 'within their control'¹⁸. In the absence of any contrary intention, client money is held by firms on trust for their clients and may only be applied in accordance with a client's instructions¹⁹. In the rare event that a bank collapses, the Financial Services Compensation Scheme (**FSCS**) protects eligible claimants up to £85,000 each.

A TPMA is, at a basic level, nothing more than a bank account held in a TPMA provider's name. The safeguarding rules set out in the Payment Services Regulations 2017 (**PSR 2017**) require payment institutions to ensure that funds are either held subject to an insurance policy or bank guarantee, or held in an account which is segregated from their operational accounts with:

- an 'authorised credit institution', being a bank or similar financial institution, which is authorised to take deposits or other repayable funds from the public and grant credit on its own account;
- the Bank of England; or
- an 'authorised custodian', being a financial institution which is authorised to hold and safeguard client assets, on condition that they are only invested in secure, liquid assets, as approved by the FCA.

As such, there is no material difference when it comes to 'control of balances'. Indeed, TPMA providers may make it easier for firms to identify receipts and payments in relation to individual client matters, using virtual accounts and technology that enables automatic reconciliation of payments.

Since 12 March 2023, FSCS protection has been extended to payment accounts held by payment institutions with banks that are regulated by the Prudential Regulation Authority, thereby levelling the playing field for payment institutions when it comes to ensuring that client monies are protected in the rare event of a bank's insolvency.

(b) Control over payments

Aside from firms' internal cash management and authorisation processes, the execution of payment transactions involves a fee earner or cashier keying account and payment details into a banking portal. There is no interference by anyone else in that process.

¹⁸ IRN Research, Spinnaker *Client Accounts Research Report for CILEx Regulation*, March 2022, page 18 <https://cilexregulation.org.uk/wp-content/uploads/2022/04/IRN-Research-Spinnaker-Client-Accounts-Research-Report-29th-March-2022.pdf> and Kreston Reeves, Protecting the public: The SRA's consumer protection review – Our thoughts, 18 July 2024 <https://www.krestonreeves.com/news/protecting-the-public-the-sras-consumer-protection-review-our-thoughts/>

¹⁹ See *Twinsectra Limited v Yardley* [2002] UKHL 12 (see Lord Hoffman's judgment at paras 12-13)

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The label 'third party managed account' implies that it is the TPMA provider, rather than the firm, which authorises the execution of payment transactions, thereby introducing transactional friction and the potential for delays. This is a particular concern for those in conveyancing, who are concerned that a lack of control over payments will prevent them from giving professional undertakings, which currently underpin conveyancing transactions²⁰.

In practice, TPMA providers should only interfere in the execution of payment transactions where a risk of fraud and financial crime has been identified, in line with their regulatory obligations to implement effective systems and controls to deter, detect and prevent financial crime. It is likely that TPMA providers will have varying approaches towards transaction monitoring for such purposes, based on their risk appetites and technical capabilities.

As a TPMA provider we fully appreciate the need for payments to be made without delay and use the near-instant Faster Payments scheme for payments under £1 million, and the same-day CHAPS scheme for payments over £1 million. As firms authorise payments directly, we do not see any reason why they should not be able to give unequivocal undertakings.

While TPMAs should be as efficient as client accounts when it comes to payments, we have received feedback from customers that other firms involved in transactions may be reluctant to send money to a TPMA, due to:

- a lack of awareness and understanding of the regulatory status of TPMAs and how they function; and
- the Law Society Standard Conditions of Sale only contemplating deposits and completion monies being paid into a client account which is in the name of the firm receiving payment²¹.

These challenges will need to be addressed if the SRA wishes to see greater uptake of TPMAs by firms.

(c) Control over regulatory compliance

Many firms are concerned about how to reconcile their professional obligation to ensure that client money and assets are protected, with trusting a third party to comply with a very different regulatory regime²². Given the low uptake of TPMAs and resulting lack of familiarity with them, this is understandable.

At the same time, it is unrealistic to expect firms to relinquish client accounts and become familiar with a different regulatory regime; the SRA, in collaboration with the FCA and the payments industry, needs to provide firms with clear guidance they can refer to when choosing a TPMA provider.

²⁰ Several respondents to the SRA's consultation on the Accounts Rules and introduction of TPMAs in 2017 cited these concerns: SRA, *Looking to the future - Accounts Rules review, Consultation responses*, June 2017 <https://www.sra.org.uk/globalassets/documents/sra/consultations/accounts-rules-responses.pdf>

²¹ Law Society, *Standard Conditions of Sale*, 5th Edition, 2018, paras 2.2.4 and 6.7

²² SRA, *Guidance on Third Party Managed Accounts*, Updated 25 November 2019, 'Our expectations': <https://www.sra.org.uk/solicitors/guidance/third-party-managed-accounts/>

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It has been suggested that TPMA providers should report to firms on their regulatory compliance periodically, enabling firms to assess whether they should continue holding funds with a provider²³. While reputable TPMA providers should agree to provide regulatory assurance information contractually, we would caution the SRA against making this a mandatory requirement on TPMA providers, thereby creating a cross-cutting regulatory framework for the provision of payment services within the legal sector.

17. In summary, it is our view that the loss of control feared by firms when using TPMAs may be illusory and is a product of firms' unfamiliarity with how TPMAs function and how TPMA providers are regulated. When compared with client accounts, TPMAs are functionally similar at a basic level, while providers such as Shieldpay strive to provide payment solutions which enhance the way firms handle client money, mitigate cybersecurity risks, and reduce the risk of theft and financial crime.
18. Another vital element of control is accountability and transparency. Currently, firms are under no obligation to provide clients with a copy of the client account ledger for a matter. TPMA providers, on the other hand, should enable firms to grant read-only access to clients, giving them real-time visibility of payment transactions at matter level. This, in turn, should reduce the risk of misappropriation and give consumers confidence that their money is being applied for purposes they have consented to.

Alternatives to holding client money

19. While we are not unbiased, it is our view that of all the options explored in the research commissioned by the SRA²⁴, TPMAs represent the best *existing* alternative for firms that need to receive, hold, and pay funds in relation to client matters on a frequent basis; with escrow and paying agent solutions being appropriate where client matters only have such need infrequently²⁵.
20. Since the Discussion Paper was published, the SRA has shared the results of a deliberative research exercise that it commissioned²⁶. The scope of that research was to understand what consumers value in terms of protections against losing client money, the trade-offs they believe acceptable in achieving those protections, and TPMAs as an alternative. Across several workshops and a week-long online community designed to ensure that participants were fully informed about client accounts, TPMAs and the Compensation Fund, the research found that:
 - TPMAs were an important part of ensuring the careful management of client money and reducing the likelihood of misappropriation, with an impartial third party providing security;

²³ See responses from the Association of Partnership Practitioners and Crown Clarke Whitehill at FN19

²⁴ Spinnaker Research, *How other regulators and jurisdictions hold client money*, November 2024: <https://www.sra.org.uk/globalassets/documents/sra/research/spinnaker---holding-client-money-comparisons.pdf?=2024-11-20>

²⁵ Firms would typically not be a party to the escrow or paying agent agreement, but would assist their clients in procuring such services

²⁶ Thinks Insight & Strategy, *Client money consumer protection arrangements: Consumer deliberative research for the Solicitors Regulation Authority*, October 2024 <https://www.sra.org.uk/globalassets/documents/sra/research/thinks---consumer-deliberative-research.pdf>

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- while client accounts were seen to offer transparency because there is no third party involved, this did not increase participants' confidence and trust in legal services;
- while participants had concerns that TPMA providers would be chosen by the solicitor, they felt the added protection offered by TPMAs is worth paying for;
- while acknowledging the possibility of higher costs or slower transactions and a lack of transparency as clients do not have direct contact with TPMA providers (points we have addressed above), participants viewed TPMAs as a way to reduce risk of financial loss, protecting consumers and the Compensation Fund;
- participants were assured by TPMA providers having stronger protection against cybercrime than firms, which outweighed concerns that they may be a more appealing target for cybercrime than individual client accounts which are likely to have less money, but less sophisticated countermeasures; and
- overall, the vast majority of participants said they would prefer to have their money held in a TPMA rather than a client account, reflecting their preference for risk prevention rather than redress.

21. In our response to the Discussion Paper²⁷, we explained how the handling of client money not only involves receiving, holding and paying money; but includes AML and sanctions compliance, multi-currency accounts and foreign exchange, bank verification, cybersecurity, fraud prevention and maintaining a relationship with banking partners that are able to respond to challenges that complex transactions bring. Using a TPMA should not just be about taking the handling of client money outside the scope of the Accounts Rules; it should be about enhancing the way firms handle client money and enhancing consumer protection, by mitigating the risk of financial crime and misappropriation through increased accountability and transparency²⁸.

22. Having addressed several of the misconceptions surrounding TPMAs in our response to the Discussion Paper²⁹, we see two rate-limiting steps for the wider adoption of TPMAs in the longer term:

(a) Market capacity

Due to the low uptake of TPMAs to date, there is limited market capacity to service the needs of some 8,000 law firms that currently handle client money. We are, however, aware that several providers in the corporate payments market from within and outside the UK, are considering offering TPMAs. Banks are also exploring ways that they can retain existing relationships with firms, and the balances that those firms bring, through partnerships with payment providers. As such, we are confident that market capacity will increase in response to the opportunity that any regulatory shift may bring.

²⁷ See FN9, paras. 15 and 17

²⁸ See Frontier Economics, *Future Market Changes in the Legal Sector and Their Potential Impact on Client Money*, 14 November 2024 which highlights the risk of client money misappropriation brought about when firms face financial difficulty, when employees work under high pressure or when there is insufficient supervision taking place.

²⁹ See FN9, paras 21-26

(b) Liability and insurance

In striving for alternatives that offer equivalent protection to consumers as a minimum, questions regarding liability and insurance often arise. It is surprising that the consultation does not explore these matters; while they may only be relevant after the fact, they are central to the question of consumer protection.

Position regarding firms

Firms hold client money on trust for their clients absent any contrary intention³⁰. Rule 6.1 of the Accounts Rules requires firms to immediately pay into client account any amount that has been improperly withheld or withdrawn, whatever the circumstances, without limit. To the extent client money is lost due to any inability of a firm and its principals to make good any loss, a claim would be made under the firm's professional indemnity insurance (**PII**) policy.

The SRA Indemnity Rules³¹ require firms to take out and maintain PII cover of at least £3 million for firms that are incorporated, and in all other cases, at least £2 million, in accordance with the Minimum Terms and Conditions (**MTC**) as set out in Annex 1 of the Indemnity Rules. The MTC are exceptional in the degree of protection that they offer to firms' clients for loss of funds, and for the lack of any flexibility for insurers to diverge from them.

Additionally, rule 3 of the Indemnity Rules requires that firms must take out and maintain insurance that provides "*adequate and appropriate cover in respect of current or past practice taking into account any alternative arrangements the firm or its clients may make*". The SRA guidance on 'adequate and appropriate cover' sets out the factors which firms should consider, notably "*what alternative arrangement you or your clients may make to cover potential losses*" and "*the extent to which the information provided to clients about insurance cover is transparent and appropriate to their needs...*"³². It is our understanding that these 'excess policies' do not typically cover firms for loss of client money due to misappropriation or fraud committed by a firm.

³⁰ See FN19.

³¹ SRA, *Indemnity Insurance Rules*, Effective 13 December 2021
<https://www.sra.org.uk/solicitors/standards-regulations/indemnity-insurance-rules/>

³² SRA, *Guidance on adequate and appropriate indemnity insurance*, Updated 15 November 2019
<https://www.sra.org.uk/solicitors/guidance/adequate-and-appropriate-indemnity-insurance/>

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To the extent that a firm's primary PII cover, and any additional cover, is insufficient to make good any loss of client money, the SRA would likely intervene³³. Notwithstanding any intervention, a grant may be made from the Compensation Fund as the fund of last resort (with any residual balances being credited to the Compensation Fund)³⁴. Grants out of the Compensation Fund may not be made to businesses with an annual turnover or assets exceeding £2 million, charities with an annual income exceeding £2 million, or trustees of trusts with assets exceeding £2 million.

Position regarding payment institutions

The PSR 2017 requires payment institutions to fully reimburse a payer for any payment transaction that:

- has not been authorised by the payer (i.e. without their consent) by no later than the end of the business day following the day they became aware of the unauthorised transaction, unless the payer acted fraudulently or failed with intent or gross negligence to comply with any security measures put in place to protect payments (regulations 76 and 77); and
- has been incorrectly executed by the payment institution without undue delay, unless the payment institution can prove to the payer/payee and, where relevant, the payer/payee's payment service provider, that the payment transaction was executed correctly (regulations 91 and 92³⁵).

Unless a payment institution undertakes 'account information services' or 'payment initiation services', there is no legal obligation on payment institutions to take out and maintain any minimum level of insurance cover for the provision of payment services on any minimum terms. However, in practice, taking out insurance in respect of insurable risks is a prudent thing for any business to do, and a payment institution would breach several of the FCA Principles of Businesses for failing to do so. Furthermore, the contractual terms between firms and payment institutions will likely require firms to take out and maintain adequate insurance cover with reputable insurers.

³³ The circumstances in which the SRA may intervene are set out in Schedule 1, Part 1, Solicitors Act 1974 <https://www.legislation.gov.uk/ukpga/1974/47/schedule/1>

³⁴ SRA, *How we deal with money when we intervene (Statutory Trusts)*, Updated 4 July 2021 <https://www.sra.org.uk/solicitors/guidance/consumer-money-intervene/>

³⁵ Payment institutions may only contract out of regulations 91 and 92 in relation to charities with an annual income of more than £1 million or businesses with more than 10 employees and an annual turnover or annual balance sheet exceeding €2 million, which is not dissimilar to the eligibility requirements for accessing the Compensation Fund.

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A payment institution may choose to safeguard the funds that it holds by using the segregation method, or the insurance or comparable guarantee method. Where the insurance method is adopted, the policy may cover the relevant funds received by a payment institution in whole or in part, there must be no other condition or restriction on the prompt paying out of funds (save for any certification as to the occurrence of an insolvency event), and the insurer or guarantor must understand that the circumstances leading to any claim should provide no grounds to dispute their liability to pay it³⁶. The proceeds of any insurance policy or guarantee must be payable into a separate safeguarded account that is only used for holding such proceeds.

While there is no redress scheme like the Compensation Fund, depending on the circumstances and eligibility criteria, a client may seek financial redress of up to £415,000 from the Financial Ombudsman Service.

Comparative protection for consumers

It must be accepted that regardless of where and how client money is held, there is scope for consumers to be put in a position where the total amount of money lost by them may not be recoverable.

While the directors and officers of payment institutions are not required to put their hands into their pockets and make good any loss in the same way as the principals of law firms are, the reality is that those principals are unlikely to have liquid funds available to make good any significant shortfalls. If a firm's principals cannot make good any loss, there will be circumstances where claims are not met by insurers either due to aggregation, or where client money has been lost due to fraud or dishonesty and a firm's principals are deemed to have condoned the same³⁷. The Compensation Fund does not provide redress for every client that has lost money, caps individual claims to £2 million (except in exceptional circumstances), and is not bottomless in the extent to which it can meet claims.

The question, then, is whether the use of TPMA's materially reduces the level of comparative protection for consumers in circumstances where client money is lost or stolen. While it is arguable that this is not the case in light of the MTC and scope of the Compensation Fund, as noted at paragraph 20 above, this trade-off may be considered acceptable when taking into account the greater protections afforded by TPMA's in reducing the risk of client money being lost or stolen in the first instance. This view is consistent with that of the participants in the deliberative research commissioned by the SRA regarding client money and TPMA's³⁸.

³⁶ FCA, Payment Services and Electronic Money – Our Approach, November 2024 (Version 6), paras 10.56-10.69 <https://www.fca.org.uk/publication/finalised-guidance/fca-approach-payment-services-electronic-money-2017.pdf>

³⁷ Both matters were considered in the case of *Discovery Land Company LLC and others v Axis Specialty Europe SE* [2024] EWCA Civ 7.

³⁸ FN26

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Shieldpay's response

Reduction in PII premiums

One of the expectations of TPMA's was that firms would benefit from reduced PII insurance premiums. We have heard anecdotally from several of our customers that they believe their premiums *would* be significantly higher if they were holding client money. However, many insurers and brokers in the PII market do not seem to agree³⁹ for the following reasons:

- the extent to which insurers have had to meet claims falling out of Axiom Ince is not yet clear and may not be known for some time;
- loss of client money only represents a proportion of total claims;
- PII insurance if offered on a 'claims made' rather than 'claims occurred basis', looking back at a firm's claims experience and the risk associated with the sectors in which it operates;
- insurers do not know enough about TPMA to evaluate whether any risk transfer to payment institutions is likely to mitigate claims risk; and
- if it is intended that PII insurance should cover loss of funds held in a TPMA notwithstanding any claim between a firm and a TPMA provider, and the Compensation Fund will not cover loss of funds held in a TPMA, this does not reduce the overall risk for insurers.

The views of insurers are understandable; until there is sufficient traction with TPMA's, broader understanding of how they function, and data to support their effectiveness in mitigating risk and reducing the number of claims for loss of client money, any policy change regarding the holding of client money is unlikely to reduce premiums in the short term.

Proposals and ideas for consultation

Residual balances

23. The SRA has expressed concern that many firms are not proactive in reconciling client accounts and zeroing client account balances following the conclusion of matters, as required under rule 2.5 of the Accounts Rules. The retention of residual balances not only deprives the rightful owner of access to their money but presents the risk of 'teeming and lading' whereby those (typically small) balances conceal shortfalls elsewhere in the client account.
24. The SRA is therefore proposing that the term 'promptly' be replaced with a more prescriptive requirement, such as a 12-week timeframe from conclusion of a matter, with the possibility of a further 12-week timeframe, if it has not been possible to return the funds to the client or third party from which the money originated.

³⁹ See Miller, *Miller's thoughts on the SRA's Protecting the public: our consumer protection review*, 3 July 2024 <https://www.miller-insurance.com/news-and-insights/latest-insights/thoughts-on-the-sras-protecting-the-public-our-consumer-protection-review> and Quality PI, *What the SRA have got wrong about removing client money from law firms* <https://qualitypi.co.uk/what-the-sra-have-got-wrong-about-removing-client-money-from-law-firms/>

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25. While many of the firms we have spoken with have robust procedures in place for managing residual balances, we know from speaking with several reporting accountants that residual balance management is a source of anxiety particularly for smaller firms (which make up more than half of the total number of regulated firms), as they struggle to allocate the necessary resources to tracking down the client or third party to return the money to them. It would therefore seem that the challenge is not one of timescales, but one of resources.
26. The SRA has also proposed that it may impose additional requirements on firms to ensure that they keep contact details up to date, making it easier to trace payers; however, we would argue that this already a requirement under article 5(1)(d) of the UK General Data Protection Regulation which requires that *“personal data shall be accurate and, where necessary, kept up to date; every reasonable step must be taken to ensure that personal data that are inaccurate, having regard to the purposes for which they are processed, are erased or rectified without delay”*.
27. When a firm uses a TPMA, rule 2.5 of the Accounts Rules no longer applies such that the risk of regulatory action being taken in respect of residual balances falls away. This risk is effectively transferred to TPMA providers as the current safeguarding rules require payment institutions to:
 - (a) ensure that there is a corresponding ‘payment order’ for each amount received into a ‘payment account’, specifying the maximum execution time (or ‘longstop date’) for the payment services to be provided in respect of the payment amount, which may be agreed with a customer as being a specific day in the future, at the end of certain period, or on a day when the money is paid into the payment account by a payer. This is more robust than the information required when money is paid into a client account and assists with managing balances;
 - (b) undertake reconciliations as often as possible and not less than once a business day, to ensure that the amount of money it holds in a safeguarded account is equal to the amount of money it should safeguard by reference to the balances of its payment accounts; identify unallocated funds; and use reasonable endeavours to identify the customer to whom the money relates (during which time such money must be safeguarded, recorded as ‘unallocated customer funds’, and returned to the payer if it cannot be allocated); and
 - (c) where the maximum execution time/longstop date for a payment order has expired, take steps to extend it by agreement with the customer, or return the money to the payer if such agreement cannot be reached promptly.
28. Shieldpay alerts customers when agreed longstop dates for payment have expired and will agree to extend the longstop date where there is a clear reason for doing so. If Shieldpay identifies that any payment transaction would result in a small residual balance remaining, it will ask the customer whether any payment can be rounded up to account for this sum. If any residual balances remain, these are moved into a separate safeguarded suspense account pending identification of the client or third party to whom they should be paid.

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Shieldpay's response

29. The effective management of residual balances is clearly in the interest of consumers and TPMA's can greatly enhance the way that this is undertaken, while reducing the risk of regulatory action being taken against firms.

Interest on client account

30. The SRA is concerned that many firms are not accounting to clients for a 'fair sum' of interest earned on client money, as required under rule 7.1 of the Accounts Rules. The potential to earn interest income, it is suggested, may incentivise firms to hold client money for longer than necessary. The SRA is therefore proposing that, subject to a *de minimis* threshold, firms should be prevented from retaining interest.
31. As a matter of principle, it is somewhat difficult to argue that interest should belong to anyone other than the person whose asset generated the return. However, the potential economic impact that any change could have on the profession and, in turn, consumers, requires greater analysis. While large firms may be less sensitive to any policy shift, both CILEx and the CLC have remarked that their members often rely on interest income to enable them to remain competitive in the face of increasing costs of doing business. For this reason, it is our view that there should be a transitional period during which firms can adapt their business models and pricing methodologies to account for any loss of interest as a revenue stream.
32. A concern that is sometimes expressed regarding TPMA's relates to the payment of interest. A key conceptual difference between payment institutions and banks is that payment institutions cannot take deposits or any other form of refundable monies, and therefore they cannot pay 'interest' on the funds that they hold. However, the FCA guidance maintains that payment institutions may share the *income* derived from holding funds on condition that such income is not paid from 'relevant funds', which must be held in a segregated and safeguarded account, and savings facilities are not being provided.
33. Shieldpay has developed the capability to calculate the income derived from the funds that it holds, separate income from the relevant funds it holds once it has been paid by its banking partners, allocate income to individual projects, and share this with customers at a specified rate, much in the same way as banks set rates on their current accounts.
34. If the SRA determines that firms should no longer retain any amount of interest or income derived from client money, the SRA should consider whether this policy extends to funds held in a TPMA or whether it is fair for such amounts to be set-off against the costs of operating the TPMA.

Moving money from client to office account

35. The SRA is concerned that client money is not ringfenced from a firm's insolvency when it is moved from client account to office account in circumstances where firms have not yet incurred any time costs or disbursements on a matter. The SRA is therefore proposing amendments to the Accounts Rules to clarify the circumstances in which client money may be moved to office account and considering whether it is ever in the best interest of clients for firms to agree alternative arrangements regarding payment of their fees and disbursements in advance.

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Shieldpay's response

36. The SRA has queried whether the use of TPMAs could avoid situations where, for example, a court has ordered compensation to be paid into a firm's office account when it does not operate a client account. While the SRA notes that this would be permitted under the Accounts Rules, this nevertheless presents a risk to clients in the event of a firm's insolvency. This provides a clear use case for TPMAs, as the compensation received would be held in a segregated safeguarded account.

Improvements to TPMA rules and guidance

37. Below, we propose several changes that are required to Rule 11 of the Accounts Rules and the SRA's guidance on TPMAs:

(a) Rule 11

11.1 You may enter into arrangements with a client to use a third party managed account for the purpose of receiving payments from or on behalf of, or making payments to or on behalf of, the client ~~in respect of regulated services delivered by you to the client,~~ only if:

- (a) use of the account does not result in you receiving or holding the client's money ~~except where you withdraw money from a third party managed account in full or partial reimbursement of money spent by you on behalf of the client, or the third party for whom the money is held;~~ and
- (b) you take reasonable steps to ensure, before accepting instructions, that the client is informed of and understands:
- (i) ~~how the provider of the third party managed account is regulated and safeguards funds belonging to them;~~
- (ii) ~~the terms of the contractual arrangements relating to the use of the third party managed account, and in particular~~ how any fees for use of the third party managed account will be paid and who will bear them; and
- (iii) the client's right to ~~terminate the agreement and~~ dispute payment requests made by you.

11.2 You ~~are able to monitor all transactions that take place via a third party managed account or~~ obtain regular statements from the provider of the third party managed account ~~and to~~ ensure that these

- Deletion of the wording within the first paragraph of rule 11.1 reflects a concern raised by our clients that it implies that the banking facility rule still survives in relation to funds held in a TPMA, when the purposes for which a TPMA is used should be a matter between a firm and the TPMA provider.

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Shieldpay's response

- While money held in a TPMA is not 'client money' for the purposes of the Accounts Rules, the additional wording in rule 11.1(a) ensures that firms are able to take payment for fees and disbursements from funds held in TPMA.
- There is concern that the requirement to ensure that clients are informed of and understand "*the terms of the contractual arrangements*" is too broad. Instead, the focus should be on explaining how client assets are safeguarded by the TPMA provider based on the agreement between the firm and TPMA provider. This is reflected in the amendments to rule 11.1(b)(i) and (ii).
- The amendment to rule 11.1(b)(iii) addresses a misunderstanding regarding whether it is referring to the agreement between the firm and client regarding use of a TPMA, or the agreement between the firm and the TPMA provider to which the client is not a party. In any case, a client is within their rights to request that any money received from them or on their behalf is returned to them at any time, regardless of whether it is held in a client account or TPMA.
- The addition of rule 11.2 clarifies that where a TPMA provider provides real-time access to a platform enabling firms to monitor all transactions that take place via the TPMA, the requirement to obtain regular statements is not additional.

(b) TPMA guidance

There are several areas of the TPMA guidance that we believe could be amended and expanded upon to provide greater clarity to firms and TPMA providers:

- Within the '*Our expectations*' section, the guidance provides that the obligation on firms to act in the best interests of each client requires firms to ensure that the decision to use a TPMA, and the TPMA used, is appropriate in each individual case. Some firms feel that where they have undertaken the checks set out in the guidance, a firm should not be considered to have fallen short of their obligation to act in the best interest of its clients. We are willing to consult with the SRA and other TPMA providers in providing more detailed guidance for firms on evaluating TPMA providers.

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- Within the 'Checks you should do before engaging a TPMA provider' it provides that "The TPMA must be an account held at a bank or building society operated as an escrow payment service (the third party receives and disburses money on your and your client's behalf). The monies in the TPMA must be owned beneficially by the third party". This confuses two different services: TPMA (an agreement between a firm and TPMA provider where the client only has statutory rights as a payer or payee under the PSR 2017) and escrow (an agreement between a bank or non-bank payment service provider and one or more transacting parties). The language in this section should therefore be amended to clarify this, as several prospective customers have pointed this out.
- Many of the firms we have spoken to have indicated a preference for operating a TPMA in parallel with their client account, initially requiring that transactions exceeding a certain value threshold or number of payees are put through the TPMA rather than their client account. However, it is unclear from the current guidance that this is permitted. We would therefore encourage the SRA to make it clear that this is permitted, provided clients are aware of which arrangement applies to holding their money.
- Using a TPMA necessarily involves the disclosure of confidential information relating to a client's matter to the TPMA provider to provide the service and ensure that it complies with its obligations to prevent financial crime. The TPMA guidance and confidentiality guidance⁴⁰ should therefore be updated to reflect this and clients' consent obtained to the disclosure of confidential information to TPMA for such limited purposes.
- While the residual balance rule in rule 2.5 of the Accounts Rules does not apply to money held in a TPMA, as noted at paragraph 27 above, payment institutions are still required to manage residual balances. It should be made clear that firms have a duty to assist TPMA providers in ensuring that any residual balances are returned to the client or third party promptly, including by assisting a TPMA provider in communicating with a client or third party.

Conclusions and next steps

38. In our response to the Discussion Paper, we acknowledged the challenges that any regulatory shift away from client accounts could have for firms, and the importance of ensuring that TPMAs are a suitable alternative as part of any such transition.

⁴⁰ SRA, *Guidance on confidentiality of client information*, Updated 30 June 2022
<https://www.sra.org.uk/solicitors/guidance/confidentiality-client-information/>

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Shieldpay's response

39. In this response, we have delved further into the model of solicitors holding client money, exploring the distinction between firms 'holding' and 'handling' client money, and whether it makes sense for them to continue holding client money going forward. We have concluded that the market competition, efficiency, and control arguments at the centre of the debate lack the necessary rigour to defend the status quo.
40. Against a backdrop of increasing regulatory breaches around the handling of client money, the increasing number and size of interventions, and future market changes increasing the risk factors relating to client money⁴¹, it is our view that now is the time for decisive long-term action regarding the holding of client money. Without this, the profession's 'defensive moat' against consumer intolerance – and with that, confidence and trust in legal services which is at the centre of the SRA's mission – is at risk of being breached irreconcilably.
41. We have acknowledged the reservations that firms have around TPMA's in terms of cost, speed, and trust, and sought to address each of them. If the SRA takes its longer-term ambition for firms to cease holding client money forward, we fully expect the market to respond; swelling to meet the demand from firms for TPMA services, increasing price competition, and spurring innovation with a view to enhancing consumer protection, while helping firms manage risk and achieve greater efficiencies in how they operate.