The City of London Law Society

4 College Hill
London EC4R 2RB

Tel +44 (0)20 7329 2173
Fax +44 (0)20 7329 2190
DX 98936 – Cheapside 2

mail@citysolicitors.org.uk

www.citysolicitors.org.uk

F.A.O.
Solicitors Regulation Authority
The Cube
199 Wharfside Street
Birmingham
B1 1BN

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Dear Sirs

Response of the CLLS Professional Rules and Regulation Committee to the SRA's consultation "Overseas Accounts Rules" (the "Consultation")

The City of London Law Society ("CLLS") represents approximately 15,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its specialist committees. This response to the Consultation has been prepared by the CLLS Professional Rules and Regulation Committee (see list of members attached).

The Consultation Questions

1. **Do you agree with our proposal to relocate the new overseas accounts provisions from the SRA Accounts Rules 2011 into the Overseas Rules? Is anything lost in doing so?**

1.1 Yes, we agree with the relocation of the new overseas accounts provisions into the Overseas Rules. No, we do not believe that anything material is lost in doing so.

1.2 As argued in connection with the Overseas Rules 2013, we believe that the rules which apply to an overseas practice must stand independent of the domestic provisions. Positioning the new Overseas Accounts Rules as part of the Overseas Rules achieves the necessary separation, it also means that solicitors outside of England and Wales can find the principal rules which apply to their practice in one place.

2. **Do you agree with the proposed changes to the application of these overseas accounts rules? More practices will be covered by the new rules, but it should be easier to understand what does and does not apply.**

2.1 We agree with the proposed changes to the application of these overseas accounts rules.

2.2 Under the current application provisions in part 7 of the SRA Accounts Rules 2011 whether or not the overseas accounts provisions apply is highly sensitive to, and dependent on, the legal structure of the firm in question. The scope of application has thus been inconsistent within firms and as between different firms, leaving gaps in regulation. The application of the new overseas accounts rules as set out in the consultation delivers a consistency irrespective of any given firm's structure, and so better protects the solicitor brand.

3. **Do you agree with our proposed simplification of the substance of the overseas accounts rules, as set out in new overseas rule 5.1, when compared to rules 50.3-50.6 in the existing Solicitors Accounts Rules?**

3.1 We agree with the proposed simplification of the substance of the Overseas Accounts Rules as set out in rule 5.1. The proposed new rules contain all of the substantive obligations in rule 50.3 of the current SRA Accounts Rules, but allow practitioners discretion and flexibility in how they achieve compliance. This approach is less likely to give rise to conflict with local law or regulation whilst continuing to offer adequate protection to clients.

3.2 In rule 5.1(b), which deals with the payment of money into client account, we note that a new term "without undue delay" is used in place of "without delay". The latter being a defined term in the context of the current SRA Accounts Rules as meaning, in normal circumstances, either on the day of receipt or on the next working day.

We believe that the domestic definition of "without delay" is too tightly prescribed to be workable in many overseas practices, and support the use of a different term. We would nevertheless welcome an explanation of the difference between "without delay" and "without undue delay", and the inclusion of a definition of this term for the purposes of the new Rules.

3.3 In respect of rule 5.1(g), concern has been expressed that the current drafting allows solicitors or regulated firms to assume that where the local rules are silent or interest is not ordinarily paid, they would automatically be compliant by doing the same. We suggest that this rule be qualified to ensure that due consideration is given to whether this is fair and reasonable in the circumstances, as follows:

"you must: ……. account for interest on *client money (overseas)* in accordance with local law and customs, and otherwise when it is fair and reasonable to do so in all the circumstances."

3.4 Concerns have also been raised that the new overseas rules are silent on the management of residual balances, notwithstanding that part 7 of the current SRA Accounts Rules is also silent on the issue. There is clearly a risk that residual balances might be overlooked and we believe this is a reasonable concern, and would suggest the insertion of the following to address it (as a new rule 5.1(e)):

"return *client money (overseas)* to the person on whose behalf the money is held promptly, as soon as there is no longer any proper reason to retain those funds."

Whilst the SRA should also consider whether to replicate rule 20.2 of the SRA Accounts Rules (whereby money which cannot returned can be given to charity), we suspect that local law and/or regulation would prohibit this.

3.5 Rules 50.4 to 50.6 deal with the accountants report, and are thus not comparable with the new overseas rule 5.1. We deal with these in our response to question 5 below.

4. **Do you agree with our proposed new definition of client money overseas? Are there any concerns about risks this might pose either to consumers or third parties?**

4.1 We do not agree with the proposed new definition of client money (overseas).

4.2 As drafted, the definition has two significant flaws:

- it introduces the concept of "office money" which is not defined for the purposes of the overseas accounts rules - we firmly believe that the definition must stand up on its own account, and without any reference to the domestic SRA Accounts Rules 2011; and

- it excludes "money which belongs ……. to a third party" from the definition of client money - whilst we understand the rationale of the exclusion of money paid to the firm on account of billed unpaid disbursements from the definition (for reasons outlined in paragraphs 4.3 and 5.1 below), as currently drafted this has the potential to exclude all money belonging to third parties. We believe that third parties should properly enjoy the protection afforded to them by client account and so by these new Overseas Accounts Rules.

4.3 The issue arising from the inclusion of billed unpaid professional disbursements in the definition of "client money (overseas)" has been the fact that, in some instances, it triggers the accountants inspection and reporting requirement where this is the only such money held, which in these circumstances is disproportionate to the risk. The proposed removal of the routine requirement to undertake an annual accountants inspection has mitigated the practical impact of this and, as a consequence, we question whether the exclusion of billed unpaid disbursements from the definition is now necessary.

Many international firms apply a common standard and approach to client accounting throughout all of their offices, irrespective whether or not the SRA rules apply. A common definition of office and client money in both the domestic and overseas accounts rules will assist firms in this regard.

4.4 To address the issues outlined above, we believe that the a more nuanced definition of both "client money (overseas)" and "office money (overseas)" is required. A definition broadly based on the tried and tested rule 12 of the SRA Accounts Rules 2011, albeit independent of the domestic rules and applying only in the context of overseas practice, should be considered.

4.5 We would suggest the following drafting:

"**client money (overseas)** means money held or received for a *client* or as *trustee*, and all other money which is not *office money (overseas)*. This includes money held or received:

(a) as *trustee*;

(b) as agent, bailee, stakeholder, or as the donee of a power of attorney, or as a liquidator, trustee in bankruptcy, *Court of Protection deputy* or trustee of an occupational pension scheme;

(c) for payment of unpaid *professional disbursements*;

(d) for payment of taxes, duties or fees on behalf of clients or third parties;

(e) as a payment on account of *costs* and *disbursements* generally;

(f) jointly with another person outside of your practice;

(g) to the sender's order.

Office money (overseas) means money which belongs to you or your *overseas practice*. This includes money held or received in respect of:

(a) the running of your practice, for example sales tax on your practice's *fees*;

(b) *fees* due to you or your *overseas practice* against a bill or written notification of *costs* incurred which has been delivered to the client or paying party; and

(c) *disbursements* already paid by you or your *overseas practice*;

(d) *disbursements* incurred but not yet paid by you or your *overseas practice*, but excluding unpaid *professional disbursements*."

We note that the SRA is planning to commence a review of the SRA Handbook in April 2015. We would welcome a full review of the domestic and overseas definitions of client and office money as a part of this process.

4.6 Concerns have been expressed that the removal of the prescriptive conditions under which money can be withdrawn from client account, contained in rule 50.3, will give rise to uncertainty as to when money can be used to settle client liabilities to the firm. The draft definition of "office money (overseas)" in paragraph 4.5 removes this uncertainty without encumbering the new rules with an unnecessary level of detail.

5. **Do you agree with our proposal to eliminate the requirement for accounts to be automatically submitted in respect of overseas practices?**

5.1 We would be interested to see the evidence that the current accountants reporting requirement "tends to encourage offices to find other ways of excluding themselves from the scope of application of the rules".

We know of CLLS member firms who have sought waivers from the SRA for certain offices, where the only "client money" held arose in connection with billing; from a small number of billed unpaid professional disbursements, credit notes raised against paid invoices, or small amounts of money paid by clients on account of future costs or disbursements. The proposed removal of the obligation to routinely undergo an accountants inspection and report will resolve this issue.

We do not know of firms seeking to exclude themselves where they are handling material client transactions. This is evidenced by the fact that many of our member firms have stated that they would continue to have some form of independent audit even if this were no longer a mandatory requirement.

It is nevertheless the view of many City firms that the blanket application to all overseas offices, irrespective of the volume of transactional activity, nature of the transactions, and amount of money held, is disproportionate to the risk.

5.2 In our response to the consultation "proportionate regulation: changes to the reporting accounting requirements" we articulated cogent arguments for retaining the accountants reporting requirement in the context of the domestic Accounts Rules. Some of the arguments around the role of the independent inspection in encouraging compliant behaviour have some relevance overseas also. In addition, the current reporting regime provides the firm and its compliance officers with assurance on the handling of client money by its overseas offices.

We nevertheless recognise that the situation overseas can be differentiated from the domestic environment:

- the firms to whom the new overseas accounts rules will apply are likely to be medium to large in size, and have a developed, resourced and managed accounting infrastructure in place;

- many of the overseas offices of such firms, and/or the individual lawyers practising within them, will be subject to local regulation. The imposition of additional audit requirements by SRA rules could result in duplication; and

- the reporting and disclosure obligations contained in part 4 of the Overseas Rules, set out very clearly the obligations of authorised persons and bodies to monitor material or systematic breaches of the overseas principles. By positioning the new overseas accounts rules under the overseas principles, these obligations would extend to encompass compliance with these rules where failures amount to material or systematic breaches only.

Our response to the earlier consultation also recognised that any change had to be considered as part of a wider review of the rules, which is what is being undertaken here in connection with the overseas accounts rules.

5.3 On balance, we agree with the proposal to remove the mandatory accountants inspection and reporting requirements.

As noted above, we believe that most firms in our sector of the market will continue to commission inspections of some sort to supplement their own internal financial management and control processes, and there are serious questions over the value of the accountants inspection and report in its current "tick box" format. We do not believe that the removal of this obligation in connection with an overseas practice gives rise to a material risk to clients. Rather, it is an opportunity for firms to remove duplication with its own internal controls, apply its own judgement as to what assurance it needs to satisfy its own regulatory obligations and, if deemed necessary, to focus the work of its external accountant on activity which is risk assessed and adds real value for the firm involved.

5.4 We do not know how many SRA regulated sole practitioners or small firms are practising overseas, and note that at least one accountancy firm has reported that it is often smaller overseas offices that have the greatest difficulty in adequately segregating client money. The SRA should, of course, take its own knowledge of the size and risks associated with this segment of the legal market into account when determining whether to dispense with the requirement for an accountants' report to be automatically submitted.

6. **Drafting**

6.1 Proposed rules 4.1 and 6.3 make reference to the "overseas practice" of solicitors and RELs. "Overseas practice" is used elsewhere as a defined term to mean a practice established outside England and Wales that is owned or controlled by an authorised body. If a solicitor or REL is practising overseas as a regulated individual they will not have an "overseas practice" in the sense used in the defined term. Using this phrase in these rules may therefore cause confusion. It would be better to use the formulation used in Overseas Rule 1 with the consequence that rule 4.1 and 6.3 would read (respectively):

"4.1

You

(a) as a *regulated individual practising overseas* must ensure that you; or

(b) as a *responsible authorised body* must ensure that your *overseas practice*, and those for whom you are responsible;

comply with the Overseas Accounts Rules and any applicable requirements in local law or regulation relating to the handling of client money or assets. [...]",

"6.3

The SRA may require the delivery of an accountant's report by you:

(a) as a solicitor or REL *practising overseas* in respect of your *practice*; or

(b) as a *responsible authorised body* in respect of your *overseas practice*,

under rule 9 of the SRA Authorisation Rules or regulation 7 of the SRA Practising Regulations. This report must: [...]"

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THE CITY OF LONDON LAW SOCIETY

Professional Rules & Regulation Committee

Individuals and firms represented on this Committee are as follows:

Sarah de Gay (Slaughter and May) (Chairman)

Tracey Butcher (Mayer Brown International LLP)

Roger Butterworth (Bird & Bird LLP)

Raymond Cohen (Linklaters LLP)

Annette Fritze-Shanks (Allen & Overy LLP)

Antoinette Jucker (Pinsent Masons LLP)

Jonathan Kembery (Freshfields Bruckhaus Deringer LLP)

Heather McCallum (Consultant)

Douglas Nordlinger (Skadden Arps Slate Meagher & Flom UK LLP)

Mike Pretty (DLA Piper UK LLP)

Bill Richards (Wragge Lawrence Graham & Co LLP)

Jo Riddick (Macfarlanes LLP)

Chris Vigrass (Ashurst LLP)

Clare Wilson (Herbert Smith Freehills LLP)