

BOARD DECISION NOTE
Costs Lawyer Standards Board
Date of decision: 20 October 2020

Issue: Handling of client money and the use of third party managed accounts (TPMAs)

Board constitution: Steve Winfield (Chair): Lay NED
Stephanie McIntosh (Vice-Chair): Lay NED
Paul McCarthy: Non-Lay NED
Andrew Harvey: Lay NED
Andrew McAulay: Non-Lay NED

1. Background information and summary of the issue

This Board Decision Note documents the decision-making process in relation to the CLSB's updated guidance note on handling client money, which was adopted on 20 October 2020.

Initial evidence of harm

Principle 3.6 of the Costs Lawyer Code of Conduct provides that Costs Lawyers "must not accept client money save for disbursements and payment of [their] proper professional fees". The prohibition is supplemented by a guidance note, which can be found in the Costs Lawyer Handbook. Two issues arose in early 2020 relating to the prohibition against handling client money, and the CLSB identified an emerging need to revisit whether the prohibition was having the intended effect and whether its formulation remained fit for purpose.

First issue

The first issue arose in the context of a disciplinary matter. The CLSB received a complaint that a Costs Lawyer had accepted or solicited client money in the course of a costs dispute. The Costs Lawyer provided evidence to demonstrate that they had neither handled nor solicited client money as prohibited by the Code of Conduct, and the complaint was ultimately closed. However, the case raised a point of wider importance around the potential risk to consumers where a Costs Lawyer provides regulated legal services through an unauthorised firm or entity (as they are entitled to do), and the unauthorised entity rather than the Costs Lawyer accepts money from or on behalf of a client.

The board discussed the issue at its meeting on 22 April 2020. It considered whether the CLSB's regulatory arrangements provided adequate consumer protection in such circumstances and/or whether additional guidance was warranted in light of learnings from the disciplinary case. The board took into account the likely expectations of a consumer who instructs (or believes they are instructing) a Costs Lawyer and the information a consumer might need to understand the scope of the regulatory protections available to them. The board also considered the extent of the CLSB's regulatory reach and worked through options for enhancing consumer protection within those limits. Board members were mindful of the risk that a policy intervention could lead to consumer harm if, in practice, it resulted in consumers dealing more with unregulated entities and less with regulated Costs Lawyers.

The board concluded that there was no obvious policy solution under which better consumer outcomes could be guaranteed (within the limited scope of the CLSB's jurisdiction). The board discussed possible sources of further comparative evidence and advice, and agreed that a mix of legal, policy and practical expertise were required to inform the CLSB's approach.

Second issue

The second issue was raised by a member of the public who enquired about whether Costs Lawyers were – or should be – permitted to use third party managed accounts (TPMAs) to deal with client money. TPMAs are used in a similar way to an escrow account, such that the lawyer never directly handles money while it belongs to the client. At its meeting in April 2020, the board was provided with information about the nature and purpose of TPMAs, and considered their potential use by Costs Lawyers. The board concluded that Costs Lawyers could use TPMAs to deal with client money within the framework of the existing rules, and that TPMAs provided an opportunity to mitigate a variety of risks.

The board also discussed the role that TPMAs could play in assisting Costs Lawyers to address unmet legal need, by allowing Costs Lawyers to take on more lay clients without the perceived risk of non-payment. Using TPMAs would also avoid disproportionately burdensome regulation, by allowing Costs Lawyers to deal with client money without the need for a compensation fund or more stringent anti-money laundering requirements.

The board asked the executive to compile additional evidence relating to both issues and report back to the board at its July meeting.

Evidence gathering and policy development

Between April and July, the executive developed an options report for the board, informed by evidence obtained through discussions with:

- policy consultants with experience of client money issues;
- a policy adviser at the Solicitors Regulation Authority who leads their work on TPMAs;
- a director at the Council for Licensed Conveyancers who was involved in their testing of TPMA products;
- practitioners and clients;
- the leading market provider of TPMAs.

The report considered the opportunities and risks associated with a range of options, including:

- expressly permitting or promoting the safe use of TPMAs;
- developing new guidance;
- amending Principle 3.6 of the Code of Conduct;
- partnering with a TPMA provider to develop a bespoke product for Costs Lawyers;
- extending the CLSB's regulatory reach on client money matters beyond individual practitioners.

The board discussed the report and the policy options at its meeting on 21 July 2020. It considered the evidence of potential consumer harm under each option as well as evidence of demand from practitioners for safe ways to deal with client money. Board members discussed the functionality, risks and costs associated with TPMAs and the various models available in the market. They again discussed the efficacy of the current rules on client money and whether the issues could be addressed through targeted guidance and education.

The board concluded that a staged policy solution was appropriate. The existing evidence of potential consumer detriment could be addressed by developing guidance on:

- safeguarding client assets for Costs Lawyers who practise in unregulated entities, linking this to existing obligations in the Code of Conduct; and
- the safe use of TPMAs as an alternative to handling client money.

Take-up of TPMAs could be monitored following implementation of the guidance and feedback could be sought from practitioners about any barriers to use. The need for further intervention could then be assessed once the impact of the guidance was understood.

Following the meeting on 21 July 2020, draft guidance was developed by the executive, with input from the stakeholders mentioned above.

2. Evidence considered by the Board

- Initial evidence of market demand for handling client money
- Disciplinary case summary
- Options report from the executive summarising stakeholder engagement and potential policy approaches
- Draft updated guidance

3. Recommendation(s) of the executive and/or Chair

The board was asked to consider the draft guidance note, which was put forward by the CEO for discussion. The Chair commended the draft to the board and invited feedback.

The CEO also recommended that the existing guidance on Principle 3.6 of the Code of Conduct be revoked.

4. Summary of deliberations

The board considered the draft guidance and agreed that it delivered the policy intention. Board members felt that the guidance note was practical and easy to follow. It addressed the issues comprehensively by reference to the Code of Conduct, without straying beyond the CLSB's regulatory reach.

The board discussed the risk that the guidance could alert practitioners to ways of working that were legitimate but did not lead to the best possible consumer outcomes. The board concluded that there was a greater risk from practitioners adopting such practices of their own accord, without having the benefit of guidance that would help them to do so safely and in accordance with their professional obligations.

The board reiterated its intention to assess the impact of the guidance over the coming year. If evidence from consumer complaints or practitioner feedback suggested that further intervention was warranted, the board would look at the issue again.

5. Other factors considered by the Board

Standing items for consideration are the impact of the decision on:

- the CLSB's independence
- furtherance of the regulatory objectives
- consumers, including vulnerable consumers
- the CLSB's financial position
- equality and diversity
- data privacy

Factors not already addressed in sections 1 or 4 above are:

- CLSB independence: They board considered the respective roles of the CLSB and ACL when discussing opportunities for the CLSB to proactively step into the market (for example, by establishing an umbrella TPMA for the regulated community). The board concluded that either body could take such action if it was considered necessary in the future.
- CLSB's financial position: Retaining a prohibition against handling client money, while promoting safe ways of dealing with client money through TPMAs, will preserve the CLSB's financial position (and minimise the financial burden on the profession) by avoiding the need for additional layers of regulation.
- Equality and diversity: The approach should make it more attractive for Costs Lawyers to take on lay clients, including lay clients who are in a financially vulnerable position, promoting equality at the consumer level.
- Data privacy: This decision does not impact data privacy.

6. Risk assessment

The new guidance note directly addresses a risk noted in the CLSB's risk register (R2), as well as related risks identified through the CLSB's ongoing supervision and engagement work. Mishandling of client money – or client confusion about the scope of regulatory protections – has the potential to generate poor consumer outcomes and undermine trust in the profession.

Following implementation of the guidance, the risk profile in relation to client money will be kept under review in line with the staged policy approach agreed by the board.

The decision does not import new risks. The risk of the policy approach failing to achieve its intended purpose is already captured in the risk register under R2.

7. Decision taken, including reasons for the decision (if not apparent from the above)

The board adopted the new guidance note on handling client money, the final version of which can now be found in the [Costs Lawyer Handbook](#). The board revoked the previous version of the guidance.

The board also agreed to update the CLSB's risk register to reflect implementation of the guidance note in the controls listed for risk R2 and by increasing the control adequacy rating for that risk from 3 to 4.

8. Dissenting Board members (if any), including reasons for their dissent (if not apparent from the above)

There were no dissenting board members.

9. Provision of the Legal Services Act 2007, or other legislation, under which the decision was made

Section 28 and section 1(1)(d), (e), (f) and (h) of the Legal Services Act 2007.

Board Decision Note approved by the Board on: 20 October 2020