Guidance Note
Handling client money (Principle 3.6)

20 October 2020 (version 3)

Costs Lawyer Standards Board

Principle 3.6 of the Costs Lawyer Code of Conduct reads: "You must not accept client money save for disbursements and payment of your proper professional fees".

Why can a Costs Lawyer not accept client money?

1. Transitional arrangements under Schedule 5 of the Legal Services Act 2007 (LSA) allow Costs Lawyers to provide reserved legal activities through an unauthorised body, such as a company or partnership. In this context, "unauthorised" means a body that is not authorised under the LSA by one of the legal services regulators.

2. This contrasts with other regulated lawyers, such as solicitors and barristers, who cannot provide reserved legal services through a body that is not authorised under the LSA.

3. These transitional arrangements, which can be terminated by the Lord Chancellor (on the recommendation of the Legal Services Board), continue to apply to Costs Lawyers because their activities are seen as lower risk. This is in large part because they do not traditionally handle client money. As a result, requirements such as the need to have a compensation fund, and for all costs firms to be authorised by a regulator, do not apply.

4. If Costs Lawyers were to hold client money then it might be necessary for the transitional arrangements to be brought to an end and, regardless of those arrangements, the CLSB would need to introduce new protections for Costs Lawyers' clients. These would likely include accounts rules, a requirement for external audit, one-off finance from the profession to establish a compensation fund, and annual payments-in by Costs Lawyers to maintain that compensation fund.

5. At the time of publishing this guidance note, we do not have sufficient evidence of:
   - demand from Costs Lawyers to directly handle client money; or
   - consumer harm from Costs Lawyers handling client money in breach of our rules,

to justify a lifting of the existing prohibition against Costs Lawyers handling client money, given the additional regulatory burden this would place on practitioners. We keep this position under review.

What are the exceptions to the principle that you cannot accept client money?

6. Costs Lawyers are of course entitled to be paid their professional fees and reimbursed for disbursements they have paid on their client's behalf. So, you can receive payment from clients for:
   - your invoices for professional services that you have already carried out; and
   - disbursements that you have already incurred.

7. A disbursement is a sum that you pay on behalf of your client, including the VAT element. Disbursements include, but are not limited to, court fees, counsel's fees, travel costs and some administrative costs. You would usually agree these costs with your client before they are incurred, to ensure that you have clear instructions to make the payment on the client's behalf. A failure to do so could mean you are unable to recover the disbursement from your client. You should always inform your client in advance if you intend to charge separately for items that the client might expect to be included in your professional fees, such as printing or postage.

8. Disbursements do not include costs such as hourly rates, success fees or general office overheads.

9. The prohibition against accepting client money means that Costs Lawyers cannot directly receive payments from clients in advance for professional fees that are not yet due or for disbursements that have not yet been paid on the client's behalf. Professional fees will not generally be due until an invoice is rendered.

10. Options to minimise your exposure to unpaid fees and disbursements include:
    - interim billing;

- setting a fixed fee for the service – this can be invoiced immediately and be payable before the work commences;
- inviting clients to pay disbursements directly to the relevant third party;
- payments being held in a third party managed account (see paragraph 22).

How does this apply in the context of costs disputes?

11. Examples of types of client money that you cannot directly accept in the context of a costs dispute include:
    - funds from an opponent to satisfy a costs award made in your client's favour;
    - funds from your client to satisfy a costs award made against that client;
    - money on account of your own costs and disbursements.

What about Costs Lawyers in solicitors' firms or other firms authorised under the LSA?

12. Around half of Costs Lawyers work in solicitors' firms. If you do, then provided any client money is held by the firm itself, the prohibition in Principle 3.6 is not relevant. The money will be protected under the terms of the Solicitors Regulation Authority's Accounts Rules and insurance and compensation fund provisions.

13. The same principles will apply for Costs Lawyers who work in firms authorised by other LSA regulators, such as CILEx Regulation.

What about Costs Lawyers practising on their own or in partnership with others?

14. The prohibition in Principle 3.6 will apply if you are a sole practitioner. In the case of a simple partnership, the money will be held on behalf of all the partners and this will include each Costs Lawyer partner so the prohibition will also apply.

15. Under these practicing arrangements, you have the options discussed at paragraph 10 above to reduce your exposure to unpaid bills and disbursements.

These options include the use of a third party managed account (see paragraph 22 below).

What about Costs Lawyers practising through an unauthorised legal entity?

16. Where a Costs Lawyer is practising through a body that is not authorised under the LSA and has its own legal identity (usually a limited company or LLP), then if any client money is held by that body it will not be held by the Costs Lawyer themselves.

17. In such a case the prohibition in Principle 3.6 is not directly relevant. However, it is vital that if you work through such a body you safeguard clients' money and maintain the trust in the profession which allows the transitional arrangements to continue.

18. You should consider the following obligations under the Code of Conduct:

    1.1 You must act honestly, professionally and with integrity in all your dealings in your professional life and not allow yourself to be compromised.

    1.7 You must not act in any way which is likely to diminish the trust the public places in you or in the profession of Costs Lawyers.

    3.1 You must act at all times to ensure the client's interest is paramount.

    3.7 You must provide required documentation and information on an application for a practising certificate and in the event of any complaint investigation conducted by CLSB or the Legal Ombudsman.

    3.8 You must ensure that you maintain professional indemnity insurance which complies with the requirements of the CLSB. See Practising Rule 9.

    4.5 You must keep the client regularly informed as to the progress of work and keep accurate records of that work.

19. In order to comply with these obligations, you should take appropriate measures to protect client money and maintain records. These measures should, in the CLSB's view, at least include:
    - Keeping client money separate from your organisation's own money at all times in a bank or building society account in England and Wales.
    - Ensuring clients' money is not used for the running expenses of your organisation.
    - Keeping appropriate records of all transactions.
    - Restricting who has access to your clients' money and having other appropriate security arrangements in place.
    - Making sure that the professional indemnity insurance that you have in place is adequate to cover the risks of failing to account for the client money that is held by your organisation. You should consider the risks of the money being inadvertently misdirected or being fraudulently taken from the account (either by a member of your organisation or a third party, through cybercrime for example). See our Guidance Note on indemnity insurance.

20. You should also inform clients of how their money is being held and account to them at all appropriate times.

21. One way to help meet your obligations is to arrange for your organisation to pay clients' money into a safe third party managed account.

What is a third party managed account (TPMA)?

22. A TPMA is an account that is held at a bank or building society in the name of a third party, where that third party is regulated by the Financial Conduct Authority as:
    - an authorised payment institution;
    - a small payment institution that has adopted voluntary safeguarding arrangements to the same level as an authorised payment institution; or
    - an EEA authorised payment institution.

23. Money in a TPMA is owned beneficially by the third party. The account operates on terms between the third party, the client and the service provider (which in this case would be you or your organisation) as an escrow payment service.

24. Because the money is held by the third party, a Costs Lawyer who uses a TPMA does not accept or handle the client's money directly, and so does not breach Principle 3.6.

25. If you choose to use a TPMA you must ensure that the client is made aware of the terms and conditions, including when money can be withdrawn by the client and when money can be paid to you. The client should be told about any fees or charges that they may incur through use of the TPMA. Under Principle 4.6 of the Code of Conduct you must ensure that clients are able to make informed decisions about the work being undertaken on their behalf and the cost of that work. You are also required (under Principle 3.4 (i) of the Code of Conduct) to keep the client updated as to fees and charges.

26. You should monitor the TPMA (for example, through monthly statements) to make sure that your clients' funds are protected and ensure that appropriate records of all transactions are available.

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