The City of London Law Society

Furniture Makers' Hall
12 Austin Friars
London
EC2N 2HE

enquiries@clls.org
www.clls.org

Further Consultation on Client Money in Legal Services: Protecting the Client Money that Solicitors Hold

A response by the City of London Law Society (CLLS)

Introduction

The CLLS represents City lawyers through individual and corporate membership, including some of the largest international law firms in the world. The CLLS represents over 21,000 solicitors who are members of the profession in the City of London. They represent 12% of all practising solicitors. The CLLS responds to a variety of consultations on issues of importance to its members through its specialist committees. This response has been prepared by the CLLS Professional Rules and Regulation Committee.

Strengthening the accountants' reporting regime

1. Observations on your proposals

   We are supportive of the proposals to strengthen the accountants' reporting regime. It is eminently sensible that the SRA should receive all accountants' reports, qualified and unqualified, and have certainty that all non-exempt firms are compliant with the requirements of SRA Accounts Rule 12. We do not believe this will impose any significant additional burden on previously compliant non-exempt firms.
   We are in principle supportive of the proposal to introduce a mandatory annual declaration process but have reservations about some of the detail, and query how effective this will be in preventing non-compliance or identifying deliberate wrongdoing. Our comments in this regard are set out in response to your question 2.

2. Our responses to your questions:

   2.1. Q1: Do you agree with our proposal to better assure compliance with the accountants' reports regime by requiring the submission of all accountants' reports (qualified and unqualified)? Please set out your reasons and any evidence relating to your answer, including of the impacts the proposal would have.

   We agree with your proposal. The historic decision not to receive all accountants report was an error and clearly left a lacuna allowing non-compliance to go undetected. Such as we understand it, the decision was in part a response to the SRA's inability to manage the volume of reports received, a problem which can potentially now be solved by the judicious use of technology.

   2.2. Q2: Do you agree with our proposal for introducing mandatory annual declarations from client money-holding firms? Please set out your reasons and any evidence relating to your answer, including about the impact this proposal would have.

   We agree with your proposal in principle but have reservations about its effectiveness in the form proposed in consultation.

For those who declare that "they have fulfilled their obligations under the accounts rules to instruct an accountant" the SRA will subsequently obtain a copy of that firm's accountants report which can be matched to and evidences the veracity of the declaration received.

For those firm's which declare that "they consider themselves exempt from the requirement to obtain an accountants report and the reason why", the SRA is entirely reliant on the declaration and will never receive any corroborating evidence. Whilst the vast majority of respondent firm's and will make this declaration conscientiously and honestly, those who are not compliant or for whatever reason are determined to evade regulatory scrutiny may have no qualms about making a false declaration.

We would strongly suggest that the proposal be supplemented with a requirement that firms who make the declaration of exemption must submit independent evidence to support this. Possibly this evidence could be in the form of bank statements or a letter from the firm's bank, although these can very easily be manipulated by determined wrongdoers as they were in the case of Axiom Ince. A letter of confirmation from the firm's external accountant would deliver better assurance. This would involve some additional cost for exempt firms but, given the very limited scope of the matters requiring confirmation, this should not be disproportionate to the very significant risk it will address.

2.3. ***Q3: Do you agree with our proposal that reporting accountants should submit their reports directly to us? Please set out your reasons and any evidence relating to your answer, including about the impact the proposal would have.***

We agree with your proposal, which clearly depends on your obtaining the agreement of the accountant's professional bodies.

2.4. ***Q4: Do you agree with our proposal to use fixed financial penalties for failures to comply with the procedural and administrative requirements relating to the submission of reports and/or declarations? Please set out your reasons and any evidence relating to your answer, including about the impact the proposal would have.***

We agree with this in principle where the error or omission which resulted in the late submission of the accountants' report and/or declaration is clearly the fault of the firm involved.

This is where your proposal to separate responsibility and accountability for submission of the report, which remains with the firm, from the actual task of submitting it which you propose should pass to the reporting accountant, may produce an inequitable outcome. Action against firms for late submission and the application of fines must surely be mitigated where the firm can show it had reasonable grounds to believe that the report had been submitted by its accountant, and/or where it could show it exercised best endeavours to ensure it was submitted on time.

2.5. ***Q5. What are your views on our proposal to amend our guidance to set an expectation for reporting accountants to routinely seek bank confirmations to verify the list of client accounts? Please set out your reasons and any evidence relating to your answer, including about the impact the proposal would have.***

We agree with this proposal.

Whilst the UK ISA 330 and ISA 505 do not make obtaining bank confirmations mandatory, they do require auditors to consider them in connection with bank balances emphasising the fact that independent, third-party verification from the bank provides strong and reliable evidence to address the risk of misstatement. In our members' experience reporting accountants do routinely seek bank confirmation of client account balances, which is a proportionate response to the high risk they present. We see no issue in this being mandated in the rules.

Strengthening checks and balances within law firms

3. Our responses to your questions:

3.1. ***Q1: Do you agree with our proposal to prevent individuals who can unilaterally determine or direct significant management decisions in firms that are not sole owner-manager firms, and that operate above the annual turnover threshold and/or the maximum client money balance threshold, should be prevented from holding the firm's COLP and COFA roles? Please set out your reasons and any evidence relating to your answer, including about the impact the proposal would have.***

We do not agree with the proposal to prevent individuals who can unilaterally determine or direct significant management decisions in larger firms from holding the COLP and COFA roles. While the objective of strengthening checks and balances is important, a blanket exclusion risks undermining the effectiveness of compliance oversight by separating these roles from the authority, visibility, and seniority necessary to discharge them properly. Our strong view is that, without seniority and awareness of firm strategy at a board level, COLPs lack the authority to embed compliance and challenge governance effectively.

Evidence from the SRA's thematic review shows that firms typically appoint individuals of seniority as compliance officers. This seniority supports necessary influence, access to information, and the ability to challenge, all of which are essential to the roles. Removing senior decision-makers from compliance roles risks depriving the COLP/COFA of the level of strategic visibility needed to detect and manage risk early and to influence firm decisions. The result would be the opposite to that intended – compliance with regulatory requirements risks becoming a tick box exercise undervalued by those who set the direction of the business. Effective COLPs require board-level visibility and influence; removing those with authority and clout can eliminate the check and balance where it is most needed. Our concern is that this proposal is a one-size-fits-all response to isolated failures by bad actors (e.g. Axiom Ince) rather than a calibrated, risk-based measure that targets the underlying supervisory gaps.

The consultation has not defined what constitutes a "significant management decision" (proposed Rule 8.4(b)). This creates material uncertainty and the risk of inadvertent disqualification of suitably senior and effective role-holders. Clarity is essential to avoid arbitrary application and to preserve accountability in governance structures. If a COLP sits on the management board or equivalent, are they arguably determining management decisions albeit as part of a collective? In any event a COLP who is in charge of the risk function is likely to take significant management decisions such as setting policies for onboarding.

The thematic review identifies systemic issues that this exclusion does not actually address – such as over-reliance on single individuals, lack of deputies, time constraints, and uneven understanding of obligations. Strengthening systems, risk-based controls, training, and resourcing would more directly address these risks, including requiring deputy officers, mandating documented escalation pathways, enhancing training usage, and reinforcing record-keeping and reporting. These measures align with the SRA's own findings and would improve effectiveness without unnecessarily diluting the authority of the COLP/COFA. Where the thematic review shows a lack of understanding of the role, this would appear to highlight the inadequacies of guidance and resources provided rather than demonstrating that the wrong people are in the roles.

If the proposals go into effect, larger firms, which already have mature governance structures, will be forced to appoint compliance officers without sufficient seniority or board access, impairing their ability to identify emerging risks and influence outcomes. Compliance may become more administrative and less strategic. There will also be recruitment and cost pressures, as noted by respondents and by the SRA's review, with potential fragmentation of responsibility and a reduction in clear accountability.

Finally, it may be unintended, but the proposed Rule 13.7 would appear to have the effect of automatically ceasing a COLP or COFA's designation as such if they were to breach proposed Rule 8.4(b), even in a one-off situation. This would have the effect of putting the firm into breach of its authorisation status, potentially unknowingly.

3.2. ***Q2: Do you agree with our proposed risk threshold of a firm having a turnover of above £600,000 to identify firms that present heightened risk of harm because of their size and would therefore be within the scope of new requirements for their compliance role holders?***

If not, what alternative threshold would you suggest and what impact would the adjustment have?

We do not agree that a single turnover threshold of above £600,000 is an adequate or proportionate measure for identifying firms that present a heightened risk of harm due to size. Turnover is not necessarily an indicator of risk – it varies by practice mix, business model, and the extent to which client money is held. A blunt threshold risks capturing firms whose inherent risk is low or well managed while missing others whose risk profile is high despite lower turnover.

The consultation's other proposals recognise the centrality of systems and controls, training, reporting discipline, and resourcing; thematic evidence points to weaknesses across a spectrum of firms and not exclusively at specific turnover levels. A blanket threshold may impose costs on firms whose risk profile does not justify the burden, for example by forcing smaller firms with limited suitable candidates for the COLP and COFA roles, to outsource those roles, increasing costs and moving risk management to individuals less familiar with the firm and its clients. A one size fits all approach may also divert resources from effective internal controls. On the other hand, some firms below £600,000 with complex or high-risk client-money profiles may evade needed scrutiny. A more nuanced, evidence-based assessment would be better.

3.3. Q3: Do you agree with our proposed risk threshold of a firm having held a client money balance of £500,000 or above at any point in the previous reporting period to identify firms that present heightened risk of harm because of the amount of client money that they held and would therefore be within the scope of new requirements for their compliance role holders?

We broadly agree that client-money exposure is a material driver of risk, not least due to the increasing cyber security risks, and relates closely to the policy objective of protecting client funds. However, our belief is that CLLS firms have well developed checks and balances in place to manage traditional risks to client money risks as well as sophisticated measures to mitigate cyber security risks.

Setting a threshold for all firms held at "any point in time" risks capturing firms where usual exposure is low and risks are low, for example, where there has been a recent single large completion, and may impose disproportionate requirements and over-regulation on lower risk firms.

3.4. Q4: Do you agree with our proposal that in sole owner-manager firms that operate above the client money balance threshold, but not above the annual turnover threshold, the owner-manager should be excluded from holding the COFA role but could retain the position of COLP? Please set out your reasons and any evidence relating to your answer, including about the impact the proposal would have.

We have concerns about the practicality of this proposal. Whilst we support the permitted COLP role holder element, and understand that it is intended to ensure that the highest risk to consumers (ie the treatment of client money) is addressed without eliminating the governance benefits of senior visibility and accountability for broader compliance, in our view it raises questions about the responsibility of, and liability on, third parties to whom the COFA role is outsourced. We have the same concerns around outsourcing the COFA role as set out at paragraph 3.2 above. Does this amount in practice to an additional external auditor, rather than a genuinely entrenched COFA? Firms who are caught by this should be provided with significant additional support on how to access, and best use, third party compliance services.

3.5. Q5: We are interested in your views on quantifying the impact of our proposals on the separation of roles. What evidence sources do you think would help with this? Please set out your reasons and any evidence relating to your answer.

- Replicate the measurables from the thematic review for follow up – this will demonstrate whether separating the roles directly affects the concerns identified.

- Interview board members and COLPs to attempt to quantity impact of loss of top table oversight