shieldpay

Changing Properties

Building trust in property transactions
using Third Party Managed Accounts

April 2019

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Executive summary

Technology is having a profound impact at all levels of our society. Nowhere is this more true than in the property sector, where there is a live debate about the merits of introducing new technological solutions versus the risk of moving beyond established practices.

This paper aims to advance that debate by examining the role that technology-enabled Third Party Managed Account (TPMA) services can play in addressing common issues and improving the experience of property transactions in the UK.

Key findings

- Technology-enabled TPMAs have the potential to radically reduce the time and cost burdens of property transaction administration and compliance compared to using client accounts, benefitting not just buyers and sellers, but also lawyers, lenders, insurers and regulators.
- TPMAs can help reduce the risk of delays, cancellations, and the misuse of client money, which are major problems affecting consumers and professionals involved in property transactions (delays and cancellations due to late funds or property vacation cost UK consumers £15m per year, while the misuse of client money saw payouts of £100m in the preceding five years from the Solicitors Regulation Authority Compensation Fund).
- TPMAs are recognised by bodies that regulate Solicitors, Licensed Conveyancers and CILEx practitioners, but clarity is needed on how liability should be apportioned where TPMAs are used as compared with the use of client accounts.
- While there are plans to issue specific guidance to clarify TPMAs' regulatory status, awareness amongst consumers and regulated firms about the benefits of TPMAs is low, which has produced an unwillingness to adopt them at scale for use in property transactions.

Key recommendations

- Developing common standards for TPMAs across professional regulatory bodies will help safeguard client interests, improve awareness and build trust in these solutions for all involved in transactions. The Financial Conduct Authority, the Legal Services Board, or others could plausibly lead this initiative.
- Integrating TPMA models within lending practice and guidance would support risk management and support lending innovation. The UK Finance Mortgage Lenders' Handbook could be usefully adapted to support consistent standards of behaviour for members of lending panels.
- Driving interoperability between TPMA services will help scale their adoption, but there are technical and competition law considerations to address.
- Collaboration will be essential for realising the benefits of TPMAs, and Shieldpay encourages practitioners from all sectors involved in property transactions to participate in its development community to help find collective solutions.

About Shieldpay

Shieldpay is authorised and regulated by the Financial Conduct Authority as a payment institution under the Payment Services Directive. Shieldpay's patent pending technology protects buyers and sellers in any transaction by verifying all parties to the transaction, securing funds from the buyer and only releasing funds to the seller when both sides agree they are ready.

Shieldpay's mission is to look after the most important transactions in people's lives, through total transparency, efficiency and security. Our award-winning payments platform is revolutionising peer-to-peer payments, classified marketplaces, and both international and domestic transactions involving property and mergers and acquisitions.

Shieldpay is an alumnus of the 2017 Barclays Accelerator powered by Techstars. Shieldpay has gained industry recognition as a winner of the RegTech Spotlight Award 2018 for Financial Crime, the Emerging Payments Association's VISA PAY360 PayTech Innovation Award 2018, the Barclays Fintech of the Year Award 2018 and the Innovation of the Year at the Modern Law Awards in 2019.

Funded by
Innovate UK

Innovate UK Grant

The development of Shieldpay's Third Party Managed Account solution for property transactions is part-funded by an Innovate UK grant. Written support for the grant application was provided by the Solicitors Regulation Authority, Council for Licensed Conveyancers, HM Land Registry, Barclays Bank PLC, My Home Move, Pirie Palmann and Howdens Specialist Insurance.

As part of the Innovate UK grant project, Shieldpay has established a Legal Services Advisory Board of specialist property law firms. During the period of the grant, these firms will work with Shieldpay to provide direct feedback on the development of the property transaction solution, process live transactions and to work towards establishing how TPMAs can help improve security and efficiency in their businesses.

The firms that form the Legal Services Advisory Board are as follows:

MyHomeMove	The Partnership Property Solicitors	Fletcher Longstaff The Home of Conveyancing	Angela Viney
legalzoom	conveyLAW Conveyancing Lawyers	WYM Legal.	TCS Total Conveyancing Services

Acknowledgements

In preparing this paper, we have had the help, advice and contribution of many people, but special thanks go to Alex Greer, who helped structure the paper and bring the information and contributions to life.

This paper has collated the current thinking on Third Party Managed Accounts by many industry stakeholders and we would like to thank those that contributed information and thoughts on form and content, namely:

Will Glassey
Mayer Brown International LLP

Helen Williams and Deborah O'Riordan
QBE Business Insurance

Stephen Ward
Council for Licensed Conveyancers

David Pope
CILEx Regulation

Neil Johnson
HM Land Registry

Rob Hailstone
Bold Legal Group

Sally Holdway
Teal Legal

Crispin Passmore
Passmore Consulting

Foreword

Technological innovation is having a profound impact at all levels of our society. As advances in mobile, storage, and processing technology drive unprecedented choice in the ways that we can expect to live and work, principles like speed, connectivity and openness to sharing information have become key to progress and unlocking the growth of the future.

However, these ideas mean different things to different people. From enthusiastic early-adopters to wait-and-see observers, technology is seen both as an enabler of progress and as a potentially disruptive force that could simply undermine established practices without net societal gain. In reality the future of technological adoption will not be a zero-sum game, but a question of striking the right balance between managing the risks of change and cultivating the rewards of growth.

This paper aims to take a step into that future by exploring the use of technology in the UK legal market – specifically that of technology-enabled Third Party Managed Account (TPMA) services. These services can be used for all types of legal services transactions, such as settling fees on account, probate, disputes, and commercial or corporate transactions. However, this paper will focus on the area where the application of this technology has the greatest potential to benefit consumers, firms and regulators: property transactions.

Having powered the UK's first digital mortgage settlement transaction, as well as the world's first fully-digital property chain transaction in 2018, at Shieldpay we believe that technology has the potential to revolutionise the experience of buying or selling a property. Solutions like Shieldpay's digital payment platform can reduce the stress and workload of closing day for clients and lawyers and reduce the risk of transactions failing to complete. Through greater transparency and synchronisation, the platform ensures that the security and regulatory compliance of a transaction is not just maintained, but enhanced. This technology could also offer the potential benefits of: reducing a firm's risk profile as far as PII insurance is concerned; eliminating unnecessary duplication from identity verification processes; and giving lenders greater control of money on completion.

Nevertheless, we know from our own experience and from speaking with stakeholders across the sector that moving from long-established practices to new forms of delivery raises important questions, of practicality and more fundamentally of safety and trust. It is with these three points in mind that we will attempt to answer some of the common practical questions that arise in relation to the use of TPMAs in property transactions (particularly insofar as they differ from traditional client account mechanics). We will also highlight areas where we believe dialogue and collaborative action between interested stakeholders will help fully realise the benefits that TPMAs provide, both for buyers and sellers of property and the professionals who facilitate transactions.

In this way, we hope this paper will be not just a practical guide to where TPMAs are today, but rather the start of a conversation about where they could be tomorrow. We hope to bring together interested practitioners in a network of expertise to address the sector's shared challenges, and, most importantly, build trust.

We look forward to engaging with you all as part of our development community, and to the prospect of delivering better property transactions for all. Feel free to contact me at gdunnett@shieldpay.com if you are interested in taking part in the dialogue.

Geoff Dunnett
Legal Services Director, Shieldpay

1. Introduction

1.1 The value of trust in property transactions

"While the risk of fraud... increases over time, there is a corresponding and growing risk that large scale... attacks could undermine confidence in current processes."

Buying or selling a property is one of the most important commitments that a person or business can make. It involves taking on substantial obligations that potentially implicate their past (in the form of assets invested as capital), their present (in taking on responsibility for a property's upkeep), and their future (in their duty to service debt incurred as mortgage interest and capital). It is therefore crucial that undertakings related to the transaction can be trusted, whether they be on the condition of the property in question or on the agreed terms and timings of the transaction.

For buyers and sellers, the impact of a failure to fulfil one side of a transaction varies according to circumstance, but research on behalf of the HomeOwners Alliance and Shieldpay has shed light on the scale and cost at a total market level. The study suggested that, in the UK, 115,000 home moves are delayed on an annual basis either because money does not arrive on time or sellers take longer than expected to vacate properties, with 20,500 moves cancelled altogether because of late monies. 25% of those who experienced delays or cancellations on moving day incurred costs averaging just over £500, while 14% faced costs of over £1,000. This amounts to a total unnecessary cost to homeowners of over £15 million.[1]

A sale or purchase is also significant for the array of professionals and public agencies that provide advice, information and services on which the counterparties rely. Lawyers, lenders, insurers, surveyors, land registries and regulators must all be depended on to act with probity in executing their obligations, be they fiduciary, statutory, or centred on their client relationship. Failure to deliver has serious consequences, not merely for their clients and principals, but also for their individual professional reputations, licenses, and mandates. For example, the Legal Services Board reported in a 2015 briefing paper titled 'Alternatives to Handling Client Money' that misuse of client money is one of the biggest regulatory risks in the legal sector, and that pay-outs from the Solicitors Regulation Authority Compensation Fund in the preceding five years in respect of misuse of client monies totalled in excess of £100 million.[2]

Of course, the rights and obligations of contract, professional regulation and statutory duties are powerful forces in providing assurance and access to recourse should things go wrong. Nevertheless, there cannot be complete compensation for the emotional, material and reputational resources that have been invested and are lost if there are delays or breakdowns before completion.

Quality of service, safeguards and consistency of diligence varies from lawyer to lawyer. Total supervision is impossible, and while the risk of fraud from sophisticated criminals only increases over time, there is a corresponding and growing risk that large scale successful attacks or frauds could undermine confidence in current processes. This could lead to would-be sellers or buyers losing trust in their lawyers and turning to alternative providers, or deciding not to enter the process at all; PII premiums rising and becoming unmanageable for smaller firms and sole practitioners; or lenders further restricting their panels.

1 Based on online research undertaken by YouGov 1st-3rd October 2018 on behalf of HomeOwners Alliance and Shieldpay, sample size was 4507 adults.

2 Legal Services Board, 'Proposals for alternatives to the handling of client money', June 2015, https://www.legalservicesboard.org.uk/what_we_do/pdf/20150720_Proposals_For_Alternatives_To_The_Handling_Of_Client_Money.pdf

1.2 Balancing the promise of innovation with the need to maintain trust

We can see therefore how breakdowns in trust and promises going unfulfilled can suppress supply and demand at individual and macro levels of the housing market. It is therefore interesting to note in the following examples how the promises of innovation are being balanced with the need to maintain trust in the UK property sector and across the financial and regulatory infrastructure that is its essential operating context:

Digital Street, HM Land Registry

In 2017, HM Land Registry (HMLR) announced their intention to make it simpler, faster and cheaper to register land and property, and their Digital Street research project is investigating how technology can be leveraged towards this objective.[3] So far, it has identified so-called 'pain points' that are common for parties involved in property transactions, including a lack of transparency and access to information, low levels of trust, and the duplication of identity checks and witnessing requirements for signatures.[4]

This has notably given rise to initiatives including: 'Sign Your Mortgage Deed', a service which aims to simplify the remortgage process and speed registration by replacing paper mortgage deeds with digital signatures; 'Find Property Information', which consolidates property information such as title number, purchase price, freehold/leasehold status, and mortgage details; and, finally, consultation towards fully digital conveyancing documentation.

In its second year of the Digital Street project, HMLR has embraced a collaborative model of development by bringing together partners from the financial, legal, property technology and blockchain industries. Using a real-world residential transaction, this partnership will showcase how blockchain technology could be used to improve a transfer of title, and Shieldpay will be operating as the settlement node that confirms that all payment obligations have been realised. At the time of publication, the technology run-throughs have been completed, the system is ready, and we are now standing by to execute the first appropriate transaction that arises. This feels like a truly exciting time for the world of property and TPMAs, and we look forward to sharing the insights generated from this collaborative approach with HMLR and other partners in the months ahead.

Real-Time Gross Settlement Renewal & Distributed Ledger Technology, Bank of England

The Real-Time Gross Settlement (RTGS) renewal programme will take place over an indicative timeline to 2025, aiming to build in "higher resilience, broader access, wider interoperability, improved user functionality and strengthened end-to-end risk management." Couched within a delivery framework tasked with balancing "the need to safeguard stability whilst enabling innovation," possible initiatives include 24 hour availability, increasing the number and types of admissible users, and opening the system to innovative payments technologies as they are developed.[5]

The Bank of England (BoE) is exploring how RTGS could be capable of supporting settlement systems built on Distributed Ledger Technology.[6]

3 Department for Communities and Local Government, 'Fixing our broken housing market', p.25; https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/590464/Fixing_our_broken_housing_market_-_print_ready_version.pdf

4 HM Land Registry Blog, 'Moving to our second year on Digital Street'; https://hmlandregistry.blog.gov.uk/2018/10/09/moving-to-our-second-year-on-digital-street/

5 Bank of England, 'A blueprint for a new RTGS service for the United Kingdom', May 2017; https://www.bankofengland.co.uk/-/media/boe/files/payments/a-blueprint-for-a-new-rtgs-service-for-the-uk.pdf

The procurement process for the technology delivery partner has begun for the RTGS system, with the BoE undertaking workshops and individual consultations with interested parties in February and March 2019. Alongside this, through these workshops and individual meetings, the BoE intends to build a knowledge base on the kind of legal, regulatory and technical frameworks that will enable private sector innovators to bring solutions to market that add value for consumers in specific use-cases on the renewed RTGS system. This will include a capacity to offer synchronisation by an independent provider(s) that sits outside of RTGS.

The initial February sessions have generated an excellent cross-sector perspective, with informative contributions from payment professionals ranging from established banks to challenger banks, blockchain companies, payment institutions an d others. The March session was dedicated to property transaction use-cases. Together, these concentrations of expertise have brought to bear a diverse set of experiences from similar consultative initiatives with regulators and agencies in the UK and abroad on the future direction of regulatory reform in property innovation. We hope that this provides a template for rounded and well-informed collaboration with the private sector in the future.

Escrow pilots for property transactions, Council for Licensed Conveyancers

CLC The Specialist Property Law Regulator

While no Licensed Conveyancer currently uses Third Party Managed Accounts (TPMAs) for all their transactions, the Council for Licensed Conveyancers (CLC) has supported escrow pilots in property transactions in order to explore its potential for use in activity within the CLC's regulatory remit. Both Shieldpay and another TPMA provider called Thirdfort have been supported in this manner by the CLC. Regulated firms are already expected by the CLC to declare to the regulator their arrangements for handling client money, and while property lawyers themselves have expressed interest in adopting TPMAs, this is subject to availability of products that meet their clients' and their own needs.

Open Banking opportunities

Under the revised Payment Services Directive 2015, known as PSD2, the new rules included aims to promote the development and the use of innovative online and mobile payments technologies with a set of common standards. Although Open Banking has no direct impact on property transactions per se, the applications of this technology are potentially transformative. These could include: verifying a client's identity and source of funds, being able to draw completion monies directly from a client's account without the need to share bank account details; and verifying that the sales proceeds have been deposited in the correct account.

In August 2016, the United Kingdom Competition and Markets Authority issued a ruling that required the nine biggest UK banks – HSBC, Barclays, RBS, Santander, Bank of Ireland, Allied Irish Bank, Danske Bank, Lloyds and Nationwide – to allow FCA-authorised entities to have direct access to their data. Despite this, and the hype surrounding the possible applications, the uptake of Open Banking solutions has been slow and limited to small-value transactions and analysis applications for current account transactions. There is still a great deal of consumer and industry education required for Open Banking solutions to take hold in the home buying process, but TPMA providers are key to realising the benefits of such technologies and for bringing such applications to the legal market.

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6 Benos, Garratt and Gurrola-Perez, 'The economics of distributed ledger technology for securities settlement', Bank of England Staff Working Paper No. 670; https://www.bankofengland.co.uk/-/media/boe/files/working-paper/2017/the-economics-of-distributed-ledger-technology-for-securities-settlement.pdf

1.3 The opportunities and challenges of using TPMAs in property transactions

As these examples demonstrate, with a balanced attitude to risk and reward there is huge scope for bringing innovations to market that deliver benefits for the stakeholders involved in transactions. However, given the multitude of different interests in play, it is evident that successful adoption of new technologies requires not just more information but also better modes of engagement between interested parties, whether enthusiasts or sceptics.

In the rest of this paper, we will focus on how these needs might be delivered around one particular form of innovation: technology-enabled TPMAs for property transactions.

TPMAs have long been used in the form of escrow facilities for high-value property, corporate, and finance transactions. They are usually set up on a bespoke basis, and while their establishment can be time-consuming, expensive and administratively burdensome, some law firms may prefer to use them instead of client accounts as a means of better managing financial risk and the regulatory requirements associated with holding client monies. In fact, the cost and complexity of establishing escrow facilities has historically made them inappropriate or unjustifiable for use in comparatively lower value or higher volume transactions, where monies are only held for a relatively short period of time.

TPMA and escrow solutions have also been taken up by Barristers, as they are not themselves permitted to hold client monies. The Bar Council recently announced the shutdown of its own subsidiary escrow provider (BARCO), but has also identified Shieldpay and Transpact (another TPMA service) as suitable escrow providers for the self-employed Bar.[7] This recognition follows a review of these companies' terms of service for ethical compliance by a member of the Bar Council's Ethics Committee.

In all these use-cases, technological innovation is now radically reducing the cost and hassle involved in establishing TPMAs. This has in turn expanded their range of applications to other forms of transaction, including their use as an alternative to client accounts in residential property transactions. In this area, technology-enabled TPMAs can prevent the inconveniences and costs that arise from delays and cancellations as uncovered in the HomeOwners Alliance research cited earlier. However, as a comparatively new means of managing the movement of monies for these purposes, stakeholders involved in property transactions will naturally have questions about exactly how TPMAs work and the implications of their usage on firms' responsibilities to clients, regulators and other interested parties.

This paper aims to address these questions and suggest a route forward for enabling the uptake of technology-enabled TPMAs where appropriate for use in property transactions. First, we will give a brief overview of how the movement of funds differs between property transactions that use client accounts and those that use TPMAs. We will then examine the responsibilities towards different stakeholders that are conferred on firms of Solicitors, Licensed Conveyancers and CILEx practitioners by the choice of each transaction model, making reference to both the relevant regulatory requirements and the expectations of market actors. Next, we will consider the benefits and challenges presented by each model, primarily as they apply to the firms that use them and the buyers and sellers on whose behalf they act, but also for related stakeholders including lenders, insurers and regulators. Finally, we will set out our recommendation for future actions and collaborations that we believe will help overcome the challenges identified and realise the benefits of TPMAs for the stakeholders mentioned.

Please note, for the sake of brevity and convenience this paper will use the term 'lawyer' interchangeably and collectively when making reference to Solicitors, Licensed Conveyancers and CILEx practitioners, unless specifically stated otherwise.

7 Bar Council, Barco, the Bar Council's own escrow service provider, July 2018, https://www.barcouncil.org.uk/supporting-the-bar/barco/

2. Money flow in property transactions

We begin with an overview of money flow in property transactions using client accounts and TPMAs.

2.1 Client accounts

In most residential UK property transaction chains where client accounts are used, each law firm acting for a buyer makes multiple payments to multiple parties (Figure 1).

"Time taken for monies to pass through each link of the chain can run into many hours, and can only take placing during working hours, Monday to Friday."

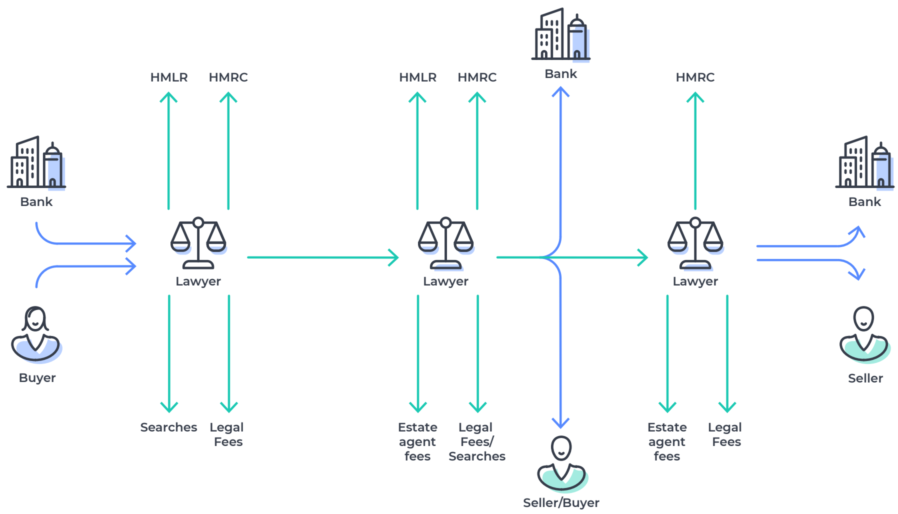

Figure 1: Money flow in chain property transactions using client accounts

Each firm's client account acts as a central point where a buyer and/or their lender deposit purchase monies while the buyer's lawyer checks that completion can occur. Once checks are complete, monies are transferred by CHAPS or Faster Payments from one firm to the next up the chain. Client accounts can also pay out administrative costs associated with the transaction, including fees for agents, lawyers, and for HMRC and HMLR (such as Stamp Duty Land Tax, registration, and search fees). Time taken for monies to pass through each link of the chain can run into many hours, and can only take place during working hours, Monday to Friday.

2.2 TPMAs

TPMA providers will naturally deliver their services in different ways according to their specific capability and the benefit-specialisms they offer their customers. However, the technology that underpins how these services operate can be described in broad terms on the basis of some core shared principles. As such, we will use Shieldpay's payment platform as an illustrative example in the explanations of technology-enabled TPMAs that follow.

TPMAs use a single central safeguarded client account to handle transactions that would otherwise have taken place sequentially along a chain via multiple client accounts (Figure 2).

"TPMAs use a single central safeguarded client account to handle transactions that would otherwise have taken place sequentially along a chain via multiple client accounts."

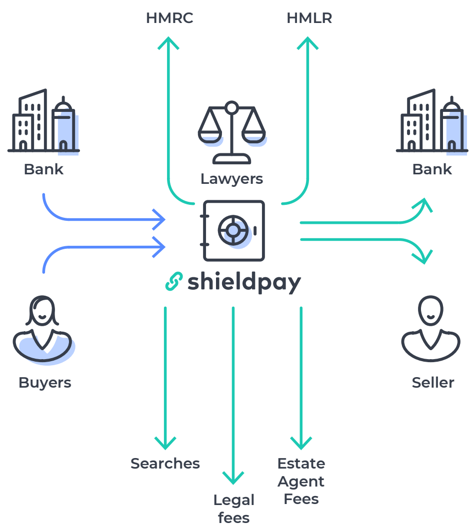

Figure 2: Money flow using TPMA in chain property transactions

First, the platform carries out identity and bank account checks, verifying all the buyers, sellers, lenders, and other parties like HMRC, HMLR, lawyers and agents involved who will either provide or receive monies in consideration of the properties being sold or for services rendered.

Buyers and lenders will then deposit monies into the TPMA's safeguarded account. The lawyer acting for the buyers will check that completion and loan conditions have been met, and will then authorise the release of the monies, at which point all financial transfers take place simultaneously in settlement of purchase amounts and administrative fees. This all occurs without the monies touching a lawyer's client monies account.

3. Responsibilities of Practitioners

Having understood the basic differences in how money moves in property transactions that use client accounts and those that use TPMAs, we will now examine the responsibilities towards different stakeholders that the choice of each transaction model confers on firms of Solicitors, Licensed Conveyancers and CILEx practitioners. This section will highlight the key regulatory requirements and expectations of market actors, with Appendix A of this paper providing a review of the regulatory framework, rule references and relevant provisions envisaged by the regulators.

3.1 Responsibilities when using client accounts

3.1.1 To Clients

Monies in client accounts are held by a lawyer in trust on behalf of a client or other stakeholder such as a mortgage lender. The account is opened and managed by the firm in accordance with their relevant professional regulations (defined by the Solicitors Regulation Authority (SRA),[8] the Council for Licensed Conveyancers (CLC)[9] and the Chartered Institute of Legal Executives (CILEx)[10] respectively).

The sets of regulations and related professional governance requirements differ slightly according to the particular regulatory body concerned. However they share the broad objective of protecting clients, and contain requirements to:

- take steps to protect a client's money and assets;
- use client accounts for appropriate purposes and not as a client's bank account;
- use each client's money for that client's matters only;
- ensure that monies held in a client account are immediately available, even at the sacrifice of interest, unless the client otherwise instructs, or the circumstances clearly indicate otherwise; and
- return monies to the client (or other person on whose behalf the money is held) promptly, as soon as there is no longer any proper reason to retain those monies.

3.1.2 To Regulators

Regarding responsibility to regulators themselves, the same guidance requires firms using client accounts to:

- deliver annual accountants' reports; and
- cooperate with regulatory bodies in checking compliance with the rules.

Mechanisms also exist at a firm and industry level to provide redress in the case of error or fraud, including:

- the legal liability of the law firm;
- compulsory PII insurance which must cover the client account up to £2m (CLC & CILEx) or £3m (SRA); and
- compensation schemes funded by the profession and administered as discretionary monies of last resort by the SRA, CLC or CILEx.

8 Solicitors Regulation Authority, 'Accounts Rules, Rule 13: Client accounts', SRA Handbook, v.21, 6 December 2018; http://www.sra.org.uk/solicitors/handbook/accountsrules/part4/rule13/content.page

9 Council for Licensed Conveyancers, 'Accounts Code', CLC Handbook, accessed February 2019; https://www.clc-uk.org/handbook/the-handbook/#Accounts-Code

10 Chartered Institute of Legal Executives, Account Rules, Rule 2 "Client Money"; "https://www.cilex.org.uk/pdf/Accounts%20Rules.pdf

3.1.3 To Lenders

In the specific case of mortgage advances, firms will also act according to the stipulations of lenders. While individual lenders may attach particular terms to the provision of funds for a given transaction, the UK Finance Mortgage Lenders' Handbook offers guidance on how firms should act on behalf of lenders in property transactions.[11] This advice includes requirements to:

- release loan funds only when the firm holds sufficient funds to complete the purchase of the property and pay all Stamp Duty Land Tax and registration fees to perfect the security as a first legal mortgage (Part 1, 10.4);
- hold in an interest-bearing account and pass on any accrued interest to the borrower(s) if completion is delayed but will occur within 7 working days of issue (Part 2, 10.10);
- ensure the firm has sufficient evidence of how the balance of monies has been paid, for example that these are paid into the borrower's lawyer's client account (Part 3, 6.1); and
- transfer the mortgage advance directly to the Seller's lawyer, who is required to hold the mortgage advance on the terms of the required undertaking (Part 3, 11).

"Money held in a TPMA does not fall under the definition of client money as set out in the SRA Account Rules because it is not money held or received by the firm."

3.2 Responsibilities when using TPMAs

3.2.1 To Clients

Money held in a TPMA does not fall under the definition of client money as set out in the SRA Accounts Rules (SARs) because it is not money held or received by the firm. The new SARs that will come into effect on 25 November 2019 make more specific reference to what firms should do in relation to the use of TPMAs (Rule 11.1 and 11.2) in order to comply with the requirements set out in the Code of Conduct and, in particular, to make sure that a client's money and assets are protected. Prior to this, in December 2017, the SRA published ethics guidance to practitioners about the use of TPMAs,[12] stipulating requirements:

- to take reasonable steps to ensure that the client understands the arrangement, including any charges or fees they are liable to pay before the agreement is entered into (Outcome 1.12 – enabling clients to make informed decisions);
- to have suitable arrangements in place for the implementation, use and monitoring of TPMAs (including having appropriate internal systems for monitoring the transactions on the account) (Outcome 7 – management of your business, and Principle 8 – running the firm's business effectively and in accordance with proper governance and sound financial and risk management principles);
- to obtain regular statements and ensure that these reflect the transactions on the account correctly;
- to make sure that the funds in the TPMA are only used for their designated purpose; and
- to maintain an overview of transactions on the account and keep appropriate records to reflect this.

A number of SRA-regulated law firms currently operate using TPMA providers, having made such notifications to the SRA.

11 Council of Mortgage Lenders, 'UK Finance Mortgage Lenders' Handbook', 1 July 2017; https://www.cml.org.uk/lenders-handbook/. Advice varies according to jurisdiction between England & Wales, the Isle of Man, Northern Ireland, and Scotland.

12 Solicitors Regulation Authority, "Ethics Guidance – Third Party Managed Accounts", 6 December 2017; http://www.sra.org.uk/solicitors/guidance/ethics-guidance/Third-party-managed-accounts-(TPMA).page.

Similarly, the CLC's Accounts Code does not prohibit the use of TPMAs, but it expects the firms it regulates to deliver the following outcomes in relation to the management of client money:

- clients receive an honest and lawful service (Outcome 1.2);
- client money is kept separately and safely (Outcome 1.3);
- appropriate arrangements, resources, procedures, skills and commitment are in place to ensure clients always receive a high standard of service (Outcome 2.3); and
- each client's best interests are served (Outcome 3.1).

The CLC is considering whether to redraft the Code to ensure that it is clear that use of TPMAs is acceptable, and to provide guidance to firms on the selection and use of TPMAs to achieve compliance with the Code. This will be informed by insights gained from the CLC's ongoing escrow pilots referenced in the Introduction to this paper. At the time of writing, we understand that no CLC firm is using a TPMA provider outside of these pilots.

CILEx goes a step further. For firms that state their intent to use escrow accounts within their original application to the Legal Services Board to become a regulated firm, there is a provision for tiered membership, a fact that indicates support in principle of firms choosing to handle client monies in alternative ways. Similarly, firms must still observe the following code of conduct principles when electing to use TPMAs:

- acting competently in the best interest of your client and respect client confidentiality (Principle 5); and
- protect client money and assets (Principle 9).

Under the new CILEx Accounts Rules that will come into force in 2019 as part of licensing applications, Rule 16 (Accounts Rules Waivers) has been made more specific to allow for the use of a TPMA provider. The intention is that if an already-licensed firm wishes to use a TPMA, a waiver will be issued under Rule 16.

3.2.2 To Regulators

The use of TPMAs by SRA-regulated firms is not prohibited under the current Solicitors Accounts Rules. The current practice for solicitors is to advise the SRA that they are using a TPMA, a notification that can be achieved by completing a simple online form.[13]

The CLC requires its firms to set out their procedures for managing and accounting for client monies when they first enter regulation and when they make any material change to relevant procedures.

CILEx offers firms the option to operate and be regulated without holding client monies themselves. Despite this, no firm has yet been able to take up this option due to the lack of commercially available systems that can efficiently manage client monies on their behalf.

3.2.3 To Lenders

The use of a TPMA rather than a client account does not change the fundamental interest that leads lenders to attach conditionality to the release of mortgage funds in order to obtain security.

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13 Solicitors Regulation Authority – TPMA Notifications; updated 6 December 2017;
https://www.sra.org.uk/solicitors/firm-based-authorisation/notify-tpma.page#Collection_2

4. Assessing TPMAs for use in property transactions

So far, we have set out how TPMAs and client accounts function, and the responsibilities that fall on firms conducting property transactions using each model. We will now consider what factors might be relevant when considering the merits of TPMAs, grouped by stakeholder for reference. These factors are by no means exhaustive, but they have been compiled from our own analysis of the market and from direct engagement with interested stakeholders.

4.1 For Clients

"The full visibility of a chain's status and the simultaneity of transfers enabled by TPMAs provide greater certainty... and removes the risk."

Speed and certainty of completion
The full visibility of a chain's status and the simultaneity of transfers enabled by TPMAs provide greater certainty that transactions will complete, and remove the risk that transactions at the end of a conventional chain would fail to complete.

Client expectation
Some clients have the expectation that holding funds is a core part of the role of their lawyer. Given that the use of TPMAs will require the consent of the client and is ultimately their choice, it is possible that a firm will have to run their client account in parallel to using a TPMA, or otherwise risk losing business should the sole use of TPMAs not accord with client expectation.

Moving day efficiencies
An increasing number of law firms provide client portals or mobile applications for clients to follow the status of their transaction, but these are not connected directly to the flow of monies and the completion of transactions. The use of TPMA providers can provide real-time notifications to all firms and clients that completion has happened, triggering the release of the keys from the estate agent and the departure or arrival of the removal van.

4.2 For Firms

Loss of professional identity
The relationship between clients and law firms are built on long-established public positions of professional credibility and clearly-defined liability. In this context, there is a widespread expectation that law firms will hold a client's monies in their client monies accounts. Firms may feel that removing this aspect of the service they have traditionally provided may precipitate some form of identity crisis for the profession, and risks devaluing their status as trusted advisors to their clients. However, just as there is no prejudice to a firm's service or standing if it chooses to outsource legal cashier work, in the same way it should be perfectly manageable to integrate the use of TPMAs seamlessly in the normal work practices of law firms while improving the experience of transactions for both the firm and the client.

Reduced risk of internal error or fraud
A TPMA's sole function is to secure funds and payments. At the most basic level, removing client money-handling from law firms removes the human risks associated with holding client money, such as misdirecting funds or internal rogue actors. Furthermore, TPMAs are likely to embrace new technologies such as those made available by Open Banking. Such Open Banking led solutions with bank account and identity verification capabilities can help reduce the Know Your Client (KYC)/Anti-Money Laundering (AML) risk for firms, and payment initiation capabilities will go a long way to stopping parties falling victim to push payment, interception and phishing scams.

"£11m was stolen from law firms' client money accounts by cybercriminals in 2017... law firms lost a shocking £85m to such attacks over 18 months beginning in 2016."

Protection from cybercriminals, fraudsters and "Friday Fraud"
The rise in attacks on law firms and their clients by cybercriminals and fraudsters is well-documented. This trend has been recognised by the National Cyber Security Centre (NCSC) in its annual report[14], in the SRA's calculation that £11m was stolen from law firms' client money accounts by cybercriminals in 2017[15] and in QBE's finding that law firms lost a shocking £85 million to such attacks in an 18 month period beginning in 2016.[16] Even the largest firm can fall victim to these kind of attacks, but smaller firms are particularly vulnerable due to lack of resource and capability to institute appropriate safeguards. The use of TPMAs and their associated protections can form a first step in helping to make smaller firms as resilient against attack as their larger competitors. TPMAs will undoubtedly become targets, but their business models are predicated on being more secure than law firms, and they should be better equipped to deal with these attacks. Surely, this is welcome news for small law firms struggling to keep pace with the rapid change and sophistication of attacks.

Dealing with non-standard clients or transactions
Within the boundaries of professional and fiduciary duties, as trusted advisors law firms are able to be flexible in relation to the clients they represent and in how they might process payments relating to a transaction. On the other hand, in order to operate efficiently a TPMA service will have to have set up systems and practices based on internal risk appetite and regulatory obligations This might mean they will not accept payments in relation to certain clients or transactions. TPMAs will not be suited to all firms, all clients or all matters. The choice of how services are provided will therefore always remain with the lawyer, who will select what is appropriate for their client as is expected by the relevant codes of conduct. Firms will not want to find themselves in a position where their TPMA provider blocks a payment after client instructions have been received and completion on a transaction is approaching.

Increased moving-day efficiencies
By consolidating the settlement of purchase and administrative costs, technology-enabled TPMAs reduce the impact of unbillable administrative tasks. These include chasing lenders for notification of fund transfers, or fielding agents' and clients' calls, which can be a drag on profitability and increase workload for firms on moving day. From research carried out by Shieldpay with the members of the Bold Legal Group, 50% of respondents stated that they called lenders the day before completion to confirm that funds were on their way, and that these calls took firms on average 10-20 minutes in each case.

Transaction timing flexibility
The transparency inherent in TPMAs removes the need to rely on transactions taking pace within banking hours. This opens the realistic possibility of transactions closing outside of normal business if necessary, which could provide firms with greater leeway in deciding how they manage casework or deal with unforeseen incidents.

Improved risk management profiles
The risk management protocols inherent to TPMA identification and transfer mechanics may support reductions in a firm's PII insurance premiums if TPMAs are seen to facilitate good practice and risk management. We are grateful to QBE Business insurance for providing as an Appendix to this paper an in-depth analysis from an insurer's perspective of the potential risk mitigation

14 National Cyber Security Centre, Cyber Threat to the UK Legal Sector, 2018 report, https://www.ncsc.gov.uk/legalthreat

15 Solicitors Regulation Authority, 'Risk Outlook 2017', 25 July 2017, https://www.sra.org.uk/sra/news/press/risk-outlook-2017.page

16 Financial Times, 'UK law firms fall foul of £85m Friday fraud hackers', March 2016, https://www.ft.com/content/2c5340fe-f0fa-11e5-9f20-c3a047354386

benefits for firms using TPMAs.

Reduced operational costs and risk
Funds held in TPMAs are not considered client money according to the SRA rules (a point not yet covered by the CLC or CILEx rules). In the former case, using TPMAs reduces the risk of non-compliance with rules for holding funds in client accounts, as well as reducing the administrative costs of compliance. These costs include returning funds at the end of transactions, dealing with residual balances, and the need for an Accountants Report depending on the nature of the firm's and TPMA's activity. In this light, TPMAs might be able to take over some of the more burdensome elements of maintaining client account ledgers in their entirety. We should recall however the SRA guidance that requires firms to maintain an overview of the transactions on the account and keep appropriate records to reflect this. These requirements (which are expected to be adopted by the other regulators cited so far), might in fact produce a short-term duplication of work as firms find themselves obligated both to maintain their own records and to audit the records kept by their TPMA provider.

Loss of deposit interest and transaction fees
In a low interest rate climate, interest from client monies held on client account are not significant, but should interest rates rise, this could become meaningful for firms once again. Whether a firm receives a share of the interest from the client monies held by the TPMA provider will be subject to the contractual arrangement between the TPMA provider, the client, and the firm. In a climate where firms' margins are squeezed (in particular in property transactions) many rely on the fees generated by charging a margin on payment costs and identity checks. If this now becomes a fee paid to the TPMA provider, this could impact the margins of many firms. Again, this will be a matter for negotiation with the individual TPMA provider, but the other commercial benefits associated with the use of a TPMA solution should quickly make up for this perceived loss of revenue.

Control of monies
Transactions are complicated, and things can change at the last minute. Relying on a TPMA to make changes according to changing client preference or legal advice might be less desirable in some cases than retaining direct control over client funds. This view was expressed in relation to property transactions by some respondents to the SRA consultation, with the time-sensitive nature of such transactions cited.[17]

Variations in regulatory requirements amongst TPMA providers
While the use of TPMAs is generally acceptable to the relevant regulatory bodies, there are different levels of regulatory certification amongst TPMA providers that might materially impact a firm's ability to recommend their use to a client. The SRA will accept a TPMA provider that is either authorised as a Payment Institution (PI) by the Financial Conduct Authority (FCA), or that is registered with the FCA as a small PI and has also adopted safeguarding practices equal those of an authorised PI where client funds are concerned. The principal difference between these two categories is that an authorised PI is bound by the safeguarding requirement in the Payment Services Regulations 2017, and must undergo annual audits, whilst a small payment institution is not subject to such auditing requirements. It is of course down to individual firms to advise their clients on the level of risk that each option for managing funds entails for their purposes. In any case, a clear understanding of the different regulatory and auditing requirements amongst TPMAs should be useful within this process.

17 Solicitors Regulation Authority, Summary documents 'Looking to the Future: Accounts Rules review', 12 June 2017; https://www.sra.org.uk/sra/consultations/accounts-rules-review.page

Relying on TPMAs for KYC/AML
One of the greatest inefficiencies in the home buying process is around the KYC/AML process, where a client could be required to provide information and certified documents to (i) an estate agent; (ii) a mortgage broker; (iii) a lender; (iv) lawyer; and (v) a TPMA provider. Each of these entities have differing requirements, guidance and supervision from their regulatory bodies, with the result that KYC/AML is undertaken slightly differently and at varying levels of quality throughout the industry. It is possible for regulated entities to pass information between one another or for parties to rely on the KYC/AML checks undertaken by another entity, as long as they are comfortable with the process that entity has undertaken. With sufficient market uptake of TPMAs and some common standards that could be agreed, it is possible to imagine that a TPMA could take responsibility for providing this service for all stakeholders.

What happens when things go wrong
Currently, if a law firm is a victim of fraud or is negligent in its handling of client money, clients are protected by the firm's own PII Insurance. This will vary from firm to firm, but there are minimum requirements (£2m for CLC and CILEx, and £3m for the SRA). In addition, clients may receive compensation from the regulators' compensation scheme. The maximum single grant that can be made from the SRA and CLC compensation scheme are £2m and £2m respectively. Conversely, the cover that clients might expect from a TPMA provider and the point where liability for fund handling or KYC/AML shifts from the law firm to the TPMA provider will depend on the contractual arrangements in place between the parties and a causation analysis in the event of any loss. TPMAs will have their own PII Insurance, the level of which will vary but is likely to exceed the minimum required for law firms. TPMAs are also likely to have additional Cybercrime cover, which is not a current requirement for law firms. Conceptually, the arrival of TPMA providers should clarify liability in these areas, but further discussion and guidance is required to establish who exactly a client would be entitled to sue if something were to go wrong, whether the law firm will still be the target for claims that arise from faults by the TPMA provider, and whether independent claims can be made against the law firms and the TPMA provider.

4.3 For Lenders

Increased control of funds
Holding funds under the conditions of a third party arrangement gives lenders greater control over mortgage funds than if they are held in a firm's client account. This provides greater assurance as to the security of the loan against the property and certainty that completion has taken place. In the event that there is a delayed or cancelled completion, lender funds are returned directly by the TPMA, rather than lenders relying on the law firm sending the funds back.

Increased scope of lender panels
With the appropriate level of market uptake, TPMAs could help bring firms that currently fall below panel thresholds for transaction volumes up to lenders' requirements, thereby increasing the proportion of property lawyers that a lender is able to work with while observing their risk criteria.

Reduction in operational costs
Where a lender distributes funds directly via a TPMA, this could lead to a reduction in operational costs on the basis that funds from a lender could be sent directly to one destination rather than to one of over 4,000 panel firms. This would reduce the number of checks and balances required. Sending funds to a TPMA provider could also be done on a batch basis rather than on a loan-by-loan basis, reducing the individual transaction costs for the lender.

4.4 For Regulators and Government Agencies

> *"TPMA identification requirements remove the need to supply ID information and verification multiple times during the process of buying or selling a house."*

Increased transparency
TPMAs enable firms and clients to ascertain the status of funds at any given moment. Amid greater expectations from consumers and regulators on transparency in legal service provision, this aspect of TPMAs function could have a role to play in clarifying how transactions function and how costs are apportioned throughout a property project.[18]

Reduced regulatory costs
Should TPMAs be widely adopted, there may be scope for a corresponding reduction in the compensation funds levied from firms. It may also be possible to provide regulatory information directly to a regulator from the transaction itself, instead of via annual returns, money laundering statements and other manual reporting mechanisms.

Less duplication and greater standardization
TPMA identification requirements remove the need to supply ID information and verification multiple times during the process of buying or selling a property. This is not only convenient for clients and firms, but could have wider applications in setting regulatory standards for anti-money-laundering and know-your-client protocols.

HMLR integrations
Given HMLR's emphasis on digital development as covered earlier, there is the potential in future for the ID verification functions of technology-enabled TPMAs to interface directly with digitally-registered titles to resolve ownership and mortgage discharge issues, automatically highlighting any conflicts or discrepancies in ownership or rights.

18 Competition and Markets Authority, 'Legal services market study', 5 February 2016; https://www.gov.uk/cma-cases/legal-services-market-study

5. Conclusions

Throughout the stakeholder conversations that have led to this paper, we have encountered a range of perspectives on the opportunities and challenges that technology-enabled TPMAs represent for property transactions. We have heard both enthusiasm and constructive scepticism, but we have been encouraged by the evident desire amongst stakeholders involved in property transactions to learn more about how TPMAs work. We hope that this paper has helped to address some of the information gaps that we discovered and were highlighted to us in the course of our research, and we welcome any further questions or comments that readers may have after reviewing the document.

A technology lives and dies according to how far its users trust it to solve the real problems that they face day-to-day. It is therefore to be welcomed that as we write more and more TPMA providers are now entering the market. We believe this is testament to the benefits that this model of managing funds offers those involved in property transactions, and we hope to see this trend continue. However, even as these solutions become more commonplace, it is clear that some significant questions remain about the possibilities and implications of this innovation for market actors. There are also undoubtedly steps that we can take as an industry (both individually and collectively) to get the best from the technology.

"A technology lives and dies according to how far its users trust it to solve the real problems that they face day-to-day."

With this in mind, we have the following proposals for action:

Develop common professional regulatory standards
From a regulatory standpoint, the various professional bodies share a clear common imperative to safeguard client interests, and a consensus is undoubtedly emerging on the suitability of TPMAs for use by regulated firms. We believe this can be developed into a common standard and supervisory approach for TPMAs across these disciplines, serving to improve trust in these solutions for all parties. For clients, this would provide greater clarity on what they should expect and what they need to know when taking advice on the use of a TPMA. For firms, a singular regulatory benchmark would give them greater confidence in choosing TPMAs, as well asthe practical awareness of how to successfully integrate their usage into the day-to-day workings of their business. There is evidently a case to make as to who should lead such an initiative – whether the FCA, the Legal Services Board, or other – and whether some form of recognised accreditation for compliant TPMAs could be introduced by the appropriate regulator. In any case, the benefits of a common approach seem clear.

Integrate TPMA models within lending practice and guidance
By engaging early with TPMA providers as they deliver and develop their services, lenders have an opportunity to ready themselves and their operating models for the new possibilities that TPMAs facilitate. As with professional regulation, defining a single set of expectations via amendments to the UK Finance Mortgage Lenders' Handbook would help achieve a consistent standard of behaviour. The dialogue that informs this would also ensure a comprehensive understanding across the sector of how technology-enabled TPMAs work, enabling not just well-informed lending decisions but also potentially enabling innovation such as specific loan-products for TPMA-backed transactions. These measures would add value throughout the process of a transaction, and enable lenders to position themselves optimally to account for the effects of TPMA technology in their assessment of risk.

“We look forward to hearing your comments and to working with you to help us all realise the full benefits TPMAs offer property transactions.”

Drive interoperability between TPMA services
For TPMA providers themselves, achieving interoperability with other providers will be essential if the benefits they offer are to be optimally adopted at scale across the property market. Not only does this present a technical design challenge, but it will also require a careful approach to collaboration in the interests of ensuring good-practice as far as competition law is concerned. The character of industry’s collective response to these challenges will be critical.

In the end, it will ultimately be up to TPMA providers to build trust in the services that they offer, and we recognise that further meaningful stakeholder engagement will be crucial to addressing these issues successfully. Dialogue will also be necessary for parties involved in property transactions to feel confident enough to embrace TPMAs as relevant solutions to the challenges faced in day-today business operations and in support of good regulatory outcomes.

Notwithstanding, we are hugely encouraged by the positive and generous approach of the many stakeholders who have engaged in this project so far, and which we hope will be just the start of an ongoing conversation. We look forward to hearing your comments, and to working with you to help us all realise the full benefits TPMAs offer for property transactions.

APPENDIX A – The Regulatory Framework

This section comprises an overview of guidance on the use of TPMAs from professional regulators.

The Legal Services Board

In 2015, the Legal Services Board (LSB) published a briefing paper on the subject of Alternatives to Handling Client Money. This included input from the frontline regulators of legal services.

The briefing paper noted that the misuse of client money is one of the biggest regulatory risks in the legal sector, and that pay-outs under the SRA Compensation Fund in the preceding five years in respect of misuse of client funds totalled in excess of £100m. The focus of the briefing paper was said to be on providing a greater degree of choice for legal services providers, in order to reduce risk and offers other benefits to consumers, legal services providers and regulators.

For regulators, the 2015 LSB briefing paper envisaged that the use of different approaches to handling client money has the potential to drive the reduction or removal of regulation for those practitioners adopting such approaches; and that for those practitioners choosing not to hold client money at all, regulators would no longer have to oversee client money rules in the same way.

Having identified the key risks in TPMAs, the LSB identified the following objectives for regulators to focus on:

- Appropriate registration of payment institutions with HM Revenue and Customs and regulation by the FCA. To be considered as an addition to the LSB objectives, whether registration with HMLR would be required for property transaction solutions.
- The ownership and corporate structure of payment institutions to be clear, to allow for any potential conflicts to be assessed, and for the arrangement for financial stability and business continuity to be understood.
- An understanding of the provider's ability to take on the likely volume of transactions.
- Funds held in the account to be segregated, clearly identifiable, and referenced to the client and lawyer/entity. The third party provider to keep accurate records of all transactions and provide these records as necessary to the other parties.
- Clarity on fees to be charged and quality of service standards (e.g. transaction speed).
- Arrangements for interest payments which are clear and are consistent with legal regulators' rules.
- Clear information for consumers relating to each key stage of the 'trust' arrangement (i.e. the arrangements for correct release and receipt of funds between parties), rights and obligations, and routes to redress.
- Clarity on boundaries of liability making it clear who should pay out in the event any client money is lost or the third party service provider enters insolvency.

- An appropriate dispute resolution process and insurance arrangements if beneficial interest in money passes to the service provider.
- Contact points for legal practitioners and consumers.
- Arrangements for cooperating with regulators.
- Arrangements for identity checks of senders and receivers of funds and compliance with anti-money laundering regulations.
- Consideration of whether consumers will have adequate information as may be necessary to understand differences in money handling arrangements and to weigh up from their point of view the benefits and drawbacks of the various options.

SRA

In 2015, the SRA included the subject of TPMAs in its wider consultation on regulatory reform. The outcome of that consultation was that there should be a further, specific consultation on the subject within the 2016 consultation on the Solicitors Accounts Rules, and that in the meantime, firms should continue to request permission from the SRA for the uses of TPMAs.

In June 2017, as part of Phase 1 of its Looking to the Future programme, the SRA published draft new Solicitors Accounts Rules, for the purposes of consultation. As regards TPMAs, the proposed Rule is short, and in the following terms:

> "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; and
>
> (b) you take reasonable steps to ensure, before accepting instructions, that the client is informed of and understands:
>
> (i) 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
>
> (ii) the client's right to terminate the agreement and dispute payment requests made by you.
>
> 11.2 You obtain regular statements from the provider of the third party managed account and ensure that these accurately reflect all transactions on the account."

The SRA's proposal is to restrict the use of TPMAs to those operated by payment services providers that are regulated by the FCA under the Payment Services Regulations 2009.

In addition, in December 2017 the SRA published ethics guidance to practitioners about the use of TPMAs. The key points are as follows:

- the SRA does not consider firms to be required to obtain the SRA's permission to use TPMAs, but expects firms to tell the SRA that they are doing so;
- money held in a TPMA does not fall under the definition of client money in the Accounts Rules (because it is not held or received by the firm). That definitional point will not change under the proposed new SARs, but as referred to above, the new SARs will have a new section to deal with TPMAs;

- nonetheless, firms' wider obligations under the Code of Conduct will continue to apply, the practical consequences of which, under the existing Code, include the following:
  - to comply with Outcomes 1.12 (enabling clients to make informed decisions about the services they need, how their matter will be handled and the options available to them) firms need to take reasonable steps to ensure that the client understands the arrangement, including any charges or fees they are liable to pay before the agreement is entered into; and
  - to achieve O(7) (management of your business) and principle 8 (running the firm's business effectively and in accordance with proper governance and sound financial and risk management principles) firms must have suitable arrangements in place for the implementation, use and monitoring of TPMAs. This includes having appropriate internal systems for monitoring the transactions on the account;
- firms must obtain regular statements and ensure that these reflect the transactions on the account correctly, and make sure that the funds in the TPMA are only used for their designated purpose; and
- firms must maintain an overview of the transactions on the account and keep appropriate records to reflect this.

The SRA has completed its consultation on the proposed new rules in 2017, and that process has not resulted in any changes to the proposed new rules concerning TPMAs. The new Solicitors Accounts Rules are expected to be implemented by 25 November 2019.

CLC

The CLC's Accounts Code does not prohibit the use of TPMAs. The CLC expects the firms it regulates to deliver the following outcomes in relation to the management of client money:

- clients receive an honest and lawful service (Outcome 1.2);
- client money is kept separately and safely (Outcome 1.3);
- appropriate arrangements, resources, procedures, skills and commitment are in place to ensure clients always receive a high standard of service (Outcome 2.3); and
- each client's best interests are served (Outcome 3.1).

As currently written, the Accounts Code assumes that a firm will manage client money through its own client account. The CLC is considering whether to redraft the Code to ensure that it is clear that use of TPMAs is acceptable and to provide guidance to firms on the selection and use of TPMAs to achieve compliance with the Code to deliver the outcomes listed above.

The revised Code and guidance will be informed by trials of the use of escrow that are currently underway with the support of the CLC and the involvement of a number of CLC-regulated firms that are interested in exploring the potential of that approach.

The CLC requires firms it regulates to set out their procedures for managing and accounting for client monies when the firm first enters regulation and expects firms to report to the CLC any material change to those procedures.

Bar Council

The Council prohibits the self-employed bar from holding of client funds in accordance with the BSB Handbook and in particular C5.1, rC73 to rC75 (Client Money) and gC 104, and has promoted the use of TPMAs and escrow providers to its members.

CILEx Regulation

These rules currently offer the option to firms to operate and be regulated without holding client funds, although with no commercially viable system currently available to its firms and CILEx members, no firms have been able to take up this option.

CILEx Regulation has been working with a number of escrow providers since it first decided to apply to be able to authorise and regulate law firms to determine the viability of any alternative solutions to its members. The use of escrow accounts formed part of its original application to the Legal Services Board, so it has always been supportive of alternative ways for the issue of holding client money to be addressed.

CILEx Authorised firms are required to ensure that they comply with the CILEx Code of Conduct. It sets out the principles to which CILEx members, CILEx practitioners and CILEx Authorised Entities must adhere in their conduct, practice and professional performance, and the outcomes they must meet.

Each principle within the Code is underpinned by a set of outcomes that a member or firm is expected to meet. This means that the Code of Conduct does not prohibit the use of TPMA's provided the required principles and outcomes are achieved. For example, the use of a TPMA would be covered within the following principles:

- principle 5 (Act competently in the best interest of your client and respect client confidentiality); and
- principle 9 (Protect client money and assets).

Within Principle 5, it requires a firm to: "adequately explain and agree with your client the terms upon which services are to be provided, including … payment and the likely or anticipated cost…" and "provide prompt, clear and accurate information and advice to your client, advise them open and honestly and keep them up to date with information…within agreed timescales."

Within Principle 9, a firm must: "Identify, assess, manage and promptly address risks to money and assets entrusted to you by clients and others" and "effectively monitor the financial stability of your business or your role within it, so as to protect client money and assets from risks associated with the financial position of your business or the business of your employer".

CILEx Regulation has decided to provide greater clarity on its approach to the use of escrow accounts within the CILEx Accounts Rules. Currently Rule 16 allows discretion for CILEX Regulation grant a waiver from compliance to the Accounts Rules to a firm if it does not hold client funds. The new Account Rules due in 2019 will make this far more specific for the use of an escrow (or TPMA).

APPENDIX B – An insurer's perspective on risks associated with client accounts and how TPMAs can support risk mitigation

With thanks to QBE Business insurance for providing their insight in this section.

What factors do insurers consider when assessing a law firm?

Insurers calculate premiums for law firms each year by looking at two principal factors: the claims history of the firm, and the risk which the underwriter anticipates the activities of the practice presents. The underwriter exercises judgement to decide the level of risk presented by the firm's forecasted fees, which results in a "rate" to be applied to those fees. The rate is informed by the nature of the firm's work (along with historic data as to the inherent level of risk in practice areas), as well as the underwriter's perception of the firm's risk profile, its governance, and its management of risk.

What types of risk do insurers encounter in respect of law firms' client accounts?

There are three main categories of risks that arise from the operation of client accounts:

1. **Client account losses covered by law firm Professional Indemnity insurers**

Insurers indemnify a significant number of claims relating to breaches of the SRA Accounts Rules. This is principally because the definition of "claim" in the SRA Minimum Terms and Conditions for Professional Indemnity Insurance includes an obligation to remedy a breach of the SRA Accounts Rules. The obligation to remedy such a breach is deemed to be an insured civil liability.

Here follow some anonymised examples of real cases related to breaches of SRA Accounts Rules:

- Law firm X was the victim of a fraud when a third party sent an email impersonating the email address of the Managing Partner, and instructing the firm's accounts department to pay funds, totaling some £2M, from client account to a designated third party account. The fraudulent email indicated that the receiving account was that of a client, when of course it actually belonged to the unknown fraudsters. Upon discovery of the fraud, the firm had an immediate and unanswerable obligation under Rule 7 of the SRA Accounts Rules to make good the client account shortfall and sought indemnity from its insurer, who then indemnified 100% of the firm's payment, less its excess. Although the firm's only immediate loss is therefore its PI policy excess, this event will continue to be part of the firm's loss history and therefore relevant to calculation of the firm's PI premium for years to come.

- Law firm Y was subject to internal fraud conducted by a Partner over an extended period, and across multiple client probate accounts. The Partner had been with the firm many years, because of which he was in a position of trust and knowing the systems well, was able to apply work-arounds to the inadequate financial controls in place. A total of £2.8M was siphoned into fictitious accounts, accessible only to the fraudulent Partner. The insurer was obliged to make good the shortfall within a matter of days after discovery of the fraud, leaving the firm and insurers with the uncertainties associated with trying to secure recovery..

The Professional Indemnity Insurance Research report 2016-2017 stated that over 25% of firms had been targeted by scammers in the previous 12 months. Larger firms had been affected more than smaller firms with the most frequent format being spam/phishing emails.[19]

The amounts paid by insurers in this regard are not reported publicly. However, it is believed to be well over £100 million in the past five years.

In respect of this trend of fraud on client account, the SRA has said that *"if unchecked, it could lead to significant premium rises if the profession does not respond in a determined way"*.[20] The SRA states further that the insurance market view is that *"an upward trend in premiums is increasingly likely as cyber attacks and other criminals continue to target solicitors' client accounts"*.[21]

In addition to insured losses, the SRA reports that it paid out approximately £9 million for uninsured losses from the SRA Compensation Fund (from 1 November 2013 to June 2017) in scenarios relating to a firm's failure to account for money paid on account for fees and disbursements.[22]

2. Other civil claim costs to Professional Indemnity insurers

In addition to thefts from client account, the operation of client account can give rise to an increased risk of civil claims. By way of examples:

- Lawyers who hold client funds for a specific purpose can be held strictly liable for releasing those funds other than for that purpose. In the recent *Dreamvar*[23] case, the defendant law firm held the funds for its purchaser client on client account and released the funds to the lawyers acting for the "seller" without knowing that the "sellers" were fraudulent imposters who had no authority to sell the property. Both at first instance and on appeal[24] the Court held that the lawyers to the duped buyer had done nothing negligent. However, the Court held that it is to be implied into retainers of buyers' lawyers that they will only release purchase monies on completion of the purchase of the Property, and "completion" means a genuine completion with the effect that the lawyers had strict liability for breach of trust in paying the funds away in breach of the implied undertaking.
- Lawyers who hold funds from clients for the purposes of transactions can find themselves facing claims in respect of those funds from third parties who assert that the funds belong to them. In these situations the lawyers may have committed no fault and will not usually assert an independent entitlement to any of the funds but can nonetheless find themselves caught in a contest over ownership of the funds between their client and the third party.
- In the same situation as above, where the firm of lawyers has innocently paid away the funds, on the client's instructions, the firm can find itself sued by a third-party asserting ownership of the funds as "constructive trustee".

19 Page 34 of the PI Insurance Report 2016-2017 by Mustard for The Law Society

20 Page 82, *"Protecting the users of legal services: balancing cost and access to legal services"* consultation paper (March 2018)

21 Page 43, *"Protecting the users of legal services: balancing cost and access to legal services"* consultation paper (March 2018)

22 Paragraph 33, SRA paper: *"Our response to consultation: Accounts Rules review"*, June 2017

23 *Dreamvar (UK) Ltd v Mishcon de Reya* [2016] EWHC 3316 (Ch)

24 [2018] EWCA Civ 1082

3. Regulatory investigations

Insurers are not required by the Minimum Terms for lawyers' Professional indemnity policies to provide cover to law firms for the costs of investigating breach of the SRA Accounts Rules, unless the investigation arises from a civil claim (or circumstances which may give rise to such a claim).

However, in practice, many insurers do provide such costs cover, and the costs of these investigations can be very high. Of course, if they are not covered by the PI policy, those investigation costs will fall to the firm itself.

In recent years, the SRA has been very active in investigating two Rules within the SRA Accounts Rules, namely Rule 14.4 which requires firms to deal promptly with leftover client account balances, and Rule 14.5 which prohibits the use of client account as a bank account for a client: client account must only be used in respect of instructions relating to an underlying transaction. The SRA's concern which is behind this investigation activity is primarily because of the risk of law firms becoming involved – even inadvertently – in money laundering activity.

The costs to law firms and their insurers of these investigations is very high. If an investigation results in a prosecution by the Solicitors Disciplinary Tribunal (SDT), the costs can be in the tens of thousands of pounds, potentially comprising both fines imposed by the SDT and the investigation costs of the SRA. Guidance issued by the SDT Policy Committee in December 2018 outlined the following Indicative Fine Bands for individuals, but it is worth highlighting that there is no limit to the fine that may be imposed:

Fine Band	Overall Assessment of Seriousness of Conduct	Fine Range
Level 1	Lowest level for conduct assessed as sufficiently serious to justify a fine	£0-£2,000
Level 2	(rather than a reprimand)	£2,001-£7,500
Level 3	Conduct assessed as moderately serious	£7,501-£15,000
Level 4	Conduct assessed as more serious	£15,001-£50,000
Level 5	Conduct assessed as very serious	£50,001 - unlimited
	Conduct assessed as significantly serious but not so serious as to result in an order for suspension or strike off	

Source: Solicitors Disciplinary Tribunal[25]

What is the potential effect of the use of TPMA on PI premiums?

As mentioned, insurers calculate premiums by examining a firm's claims history, and the risk which the continuing practice presents.

In this context, the use of TPMA accounts by law firms will have a qualitative impact on their risk profile. It is expected that law firms that routinely use a TPMA for transactions will inevitably experience an improvement in the risks of civil claims and SRA Accounts Rules breaches and investigations.

Over time, it is expected that firms who routinely use TPMAs will experience improved claims histories, and in turn will be perceived by underwriters to present a lower risk profile. In turn, this should result, over time, in reduced PII rates for those firms.

25 Solicitors Disciplinary Tribunal, Guidance Note on Sanctions - 6th Edition, 12 December 2018, https://www.solicitorstribunal.org.uk/sites/default/files-sdt/GUIDANCE%20NOTE%20ON%20SANCTIONS%20-%206TH%20EDITION%20-%20DECEMBER%202018.pdf

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