Warning notice

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Improper use of client account as a banking facility

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Status

This warning notice highlights some key issues with regards to a law firm's client account being improperly used as a banking facility.

This document is to help you understand your obligations and how to comply with them. We may have regard to it when exercising our regulatory functions.

Who is this warning notice relevant to?

This warning notice is relevant to all law firms, their managers and employees who have any involvement in holding or using money received for clients or others.

For a number of years, we have warned that solicitors must not provide banking facilities to clients or others. This warning notice is a reminder of some of the key issues and risks of which you should be aware. We have also set out some case studies [https://qltt.sra.org.uk/solicitors/guidance/improper-use-client-account-banking-facility/] to help you comply with your obligations.

Our Standards and Regulations

Rule 3.3 of the SRA Accounts Rules [https://qltt.sra.org.uk/solicitors/standards-regulations/accounts-rules/] provides that:

'You must not use a client account to provide banking facilities to clients or third parties. Payments into, and transfers or withdrawals from a client account must be in respect of the delivery by you of regulated services'.

'Regulated services' means: the legal and other professional services that you provide that are regulated by the SRA and includes, where appropriate, acting as a trustee or as the holder of a specified office or appointment.

Rule 3.3 reflects decisions of the Solicitors Disciplinary Tribunal that it is not a proper part of a solicitor's everyday business or practice to operate a banking facility for third parties, whether they are clients of the firm or not.

Concerns about the improper use of client account have been clearly and more broadly stated in case law. You should make sure that you are fully aware of the relevant case law including the cases of Fuglers, (Fuglers LLP v SRA [2014] EWHC 179 (Admin)), Patel, Premji Naram Patel v Solicitors' Regulation Authority [2012] EWHC 3373 (Admin)), and Zambia (Attorney General of Zambia v Meer Care & Desai [2008] EWCA Civ 1007).

The Principles

A breach of rule 3.3 is a serious matter in itself.

If you allow your firm's client account to be used improperly this may also result in a breach of the SRA Principles by failing to act:

- in a way that upholds the constitutional principle of the rule of law, and the proper administration of justice: Principle 1
- in a way that upholds public trust and confidence in the solicitors' profession and in legal services provided by authorised persons: Principle 2
- with independence: Principle 3
- with integrity: Principle 5.

Our concerns

Law firms, their managers and employees should not allow the firm's client account to be used to provide banking facilities to clients or third parties. You must also actively consider whether there are any risk factors suggesting that the transaction on which you are acting, even if it appears to be the normal work of a solicitor, is not genuine or is suspicious.

Some of the key issues you should be aware of include the following.

Providing banking facilities through a client account is objectionable in itself

The prohibition in rule 3.3 is simple and clear: "You must not use a client account to provide banking facilities to clients or third parties." The second sentence in the rule recognises that holding and moving money for clients may not be a breach where doing so is related to proper instructions regarding a transaction on which you are acting or in connection with the delivery of regulated services. These include legal and other professional services that you provide that are regulated by us.

The courts have confirmed that operating a banking facility for clients divorced from any legal or other professional work is in itself objectionable. You are not regulated as a bank to provide such facilities. If you do provide banking facilities for clients, you are trading on the trust and reputation from your status as a solicitor in doing so.

You must therefore only receive funds into your client account where there is a proper connection between receipt of the funds and the delivery by you of regulated services. It is not sufficient that there is simply an underlying transaction if you are not providing any regulated services , or if the handling of money has no proper connection to that service.

We expect you to discuss with your clients at the outset of the retainer how their money will be dealt with. This includes confirming with the client that they have a bank or building society account to receive any monies during or at the end of their matter. You may want to include a term in your terms of business that you will only account to the client for any monies and not to a third party even if the client asks you to.

If the client does not have a bank or building society account to receive monies then you should consider arranging for money to be held in a third party managed account or another escrow facility.

Note: any exemption or exclusion under the Financial Services and Markets Act 2000 is likely to be lost if a deposit is taken in circumstances which do not form part of your regulated services.

There must be a proper connection between the delivery by you of regulated services and the payments you are asked to make or receive

The rule is not intended to prevent usual practice in traditional work undertaken by solicitors such as conveyancing, company acquisitions, the administration of estates or dealing with formal trusts. So, it does not affect your ability to make usual and proper payments from client account when they are related to the transaction (such as the payment of estate agents' fees in a conveyancing transaction).

Whether there is such a proper connection will depend on the facts of each case. The fact that you have a retainer with a client is insufficient to allow you to process funds freely through client account. You need to think carefully about whether there is any justification for money to pass through your client account when it could be simply paid directly between the clients.

Historically, some solicitors have held funds for clients to enable them to pay the client's routine outgoings. This has been mainly for the clients' convenience such as where they are long term private clients or based

abroad. In view of technological change, such as the ease of internet and telephone banking, we consider that allowing client account to be used in this way is no longer justifiable and a breach of rule 3.3. Clients can now operate their bank accounts from their own homes or indeed from anywhere in the world. Allowing clients simply to hold money in a client account gives rise to significant risks and may evade sophisticated controls and risk analyses that banks apply to money held for their customers.

Factors you should bear in mind when considering such issues include:

- Throughout the retainer, you should question why you are being asked to receive funds and for what purpose. The further the details of the transaction are from the norm or from the usual legal or professional services a solicitor provides, the higher the risk that you may breach rule 3.3.
- You should always ask why you are being asked to make a payment or why the client cannot make or receive the payment directly themselves. The client's convenience is not a legitimate reason, nor is not having access to a bank account in the UK. Risk factors could involve the payment of substantial sums to others, including family members, or to corporate entities, particularly overseas, if there is no reason why the client could not receive the money into their own account and transfer it from there.
- You have a separate obligation to return client money to the client or third party promptly, as soon as there is no longer any proper reason for you to hold those funds (rule 2.5 of the Accounts Rules). If you retain funds in client account after completion of a transaction, there is risk (depending on how long you hold the money) of breaching both rule 2.5 and 3.3

Risk of insolvency

You should be aware that a client may ask you to hold or deal with money in client account to avoid their obligations under insolvency legislation. Banks commonly withdraw facilities when told that there has been a winding up petition.

If a law firm allows its client account to be used as a banking facility in an insolvency situation to receive and process money, the client will improperly obtain a banking service which would otherwise be unavailable to it. There are also risks that in making payments to order. You may improperly favour one creditor over another.

Finally, section 127 of the Insolvency Act 1986 may apply to require creditors to reimburse payments from the client account in a subsequent liquidation. A solicitor who knowingly makes or facilitates such payments may be subject to a personal liability, in addition to the liability of the payee to reimburse the amount transferred.

Rule 3.3 and the risk of money laundering

Allowing a client account to be used as a banking facility carries with it the additional risk that you may assist money laundering. We directly monitor and enforce provisions relating to anti-money laundering and counter terrorist financing, as set out in regulations made by the Treasury as in force from time to time, including the Money Laundering, Terrorist Financing and Transfer of Funds (information on the payer) Regulations 2017 (MLRs).

You should be familiar with our warning notices on:

- Money laundering and terrorist financing [https://qltt.sra.org.uk/solicitors/guidance/money-laundering-terrorist-financing/?epiprojects=3]
- Money laundering and terrorist financing – suspicious activity reports [https://qltt.sra.org.uk/solicitors/guidance/money-laundering-terrorist-financing-suspicious-activity-reports/?epiprojects=3]
- Compliance with the money laundering regulations – firm risk assessment [https://qltt.sra.org.uk/solicitors/guidance/compliance-money-laundering-regulations-firm-risk-assessment/?epiprojects=3]
- Investment schemes (including conveyancing). [https://qltt.sra.org.uk/solicitors/guidance/investment-schemes-including-conveyancing/?epiprojects=3]

You must remain alert to any unusual or suspicious factors such as concern about the source of funds or what you are asked to do with them. Your obligation to comply with rule 3.3 offers an important 'first line of defence' against clients or others who seek to use your client account to launder money. It also helps you to secure professional independence from your client in compliance with Principle 3.

We have also seen firms making multiple transfers of money between the ledgers of different clients or companies without evidence of the purpose or legal basis for the transfers (such as Board resolutions or contracts). Transfers in such circumstances will be a breach of rule 3.3, particularly if they are simply carried out on request. It is an important principle of anti-money laundering regulation that transactions are properly recorded and can be reconstructed (see, for example, regulation 40(2)(b) of the Money Laundering, Terrorist Financing and Transfer of Funds (information on the payer) Regulations 2017. Such conduct would be of significant concern to us as it makes the tracking of money difficult and may be aggravated by the number and the value of such transfers.

Although, allowing client account to be used as a banking facility can facilitate money laundering, rule 3.3 exists independently of the anti-money laundering legislation and a breach of rule 3.3 does not require there to be evidence of laundering. If there is such evidence, we would expect a prosecution under the Proceeds of Crime Act 2002 ((see for example R v Khan (Shadab) [2010] EWCA Crim 2841 (four years' imprisonment)). It is no defence to, or mitigation, of a breach of rule 3.3

that there was no evidence of actual laundering. Indeed, such arguments indicate a lack of insight into the reasons for rule 3.3 and the risks it addresses.

For example:

- Rule 3.3 and the MLRs are to a large extent preventative provisions, intended to make it more difficult for people to use regulated businesses for improper purposes but also to deter law firms from helping such people.
- Any impropriety may be distant from the movement of money through a client account. In a classic laundering process, the movement through a client account may be the third or fourth stage of laundering the proceeds of a distant crime. But every stage contributes to the effectiveness of the laundering process.
- There are many potential forms of impropriety as well as money laundering. The Fuglers' case is one example in an insolvency context but there are many others such as hiding assets improperly in commercial or matrimonial disputes. You should also be aware of the risks in allowing your client account to be used to add credibility to questionable investment schemes.
- Movement of money through client account is attractive to those with an improper purpose:
    - Attempts by law enforcement or opposing litigants to obtain information may be blocked by a claim to privilege, even though the claim to privilege may be unsustainable on proper analysis with access to the documents.
    - It largely circumvents the sophisticated risk systems used by banks.
    - Solicitors, particularly in smaller firms, with a close relationship to an important client may be vulnerable to pressure to avoid making suspicious activity reports.

Enforcement action

You should be prepared to justify to us any decision that you make that it was appropriate for you to hold or move client money. Failure to have proper regard to this warning notice is likely to lead to disciplinary action.

Further help

If you require further assistance please contact the Professional Ethics helpline [https://qltt.sra.org.uk/contactus] .