IPReg Client money guidance

Purpose

1. This guidance explains our rules relating to the holding of money belonging to clients and how these interact with our Principles and Code of Conduct. It is mainly aimed at individual attorneys and firms regulated by us (and in particular those firms' managers and where appropriate, their Heads of Finance and Administration). It may also be relevant to consumers.

Overview

2. We have set out our rules relating to the holding of client money in section 4 of our Code of Conduct. The key requirement is to keep client money safe, identifiable and separate to money belonging to you or your firm (rule 4.1). You should also have regard to the following obligations in our Core Regulatory Framework:

    - Principle 2: You must act in a way that upholds public confidence in the regulated profession
    - Principle 4: You must be honest
    - Principle 5: You must act with integrity
    - Principle 7: You must act in the best interests of each client
    - Principle 8: You must maintain proper standards of work
    - Code of Conduct - rule 1.1 : Clients receive the best available information about your work and costs, both at the time of engagement and, when the context applies, as work progresses.
    - Code of Conduct - rule 3.2: Effective governance arrangements are in place so that you and those you contract with can comply with IPReg's regulatory arrangements.
    - Code of Conduct - rule 4.3: You may use the services of a *third party managed account* provider, in respect of money that would otherwise be held by you as client money provided that you comply with guidance issued by IPReg.

3. Many firms will meet their obligation to keep client money safe, identifiable and separate by operating a second separate business bank or building society account. Our rules provide that this should be an account located in the United Kingdom (rule 4.1.3). You should keep appropriate records of all transactions relating to your dealings with client money and have adequate security and other measures in place. You will need to make sure that you have appropriate insurance in place to cover any risks to client money, including client money being misplaced through error, fraud or a cybercrime attack - see rule 3.10 of the Code of Conduct. If client money is improperly taken, you should immediately seek to make good any deficiency.

Client money

4. We have defined the term 'client money' to mean money '*heId or received by you or your firm in connection with work undertaken for a client, excluding any advance payments for costs received where the terms have been agreed*'. We have set out what we mean by a "client" in our glossary. "Client money" will include, for example, damages received by you from the defendant after your client has won a breach of trademark claim or money received from your client to enable you to settle a losing claim on their behalf. If you receive such client money it must be promptly paid into, and held, in the separate account.

5. The definition of client money excludes '*advance payments received for costs where the terms have been agreed*'. Costs includes both fees and disbursements. "Fees" means your own charges or profit costs (including any VAT element) and "disbursements" means any costs or expenses paid or to be paid to a third party on behalf on the client or trust (including any VAT element) save for office expenses such as postage and courier fees. We explain in more detail what the exclusion means below. If you are unsure if the money you have received is excluded from the definition, you should assume that it is client money and deal with it accordingly.

<u>What is excluded from the definition of client money ?</u>

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6. "Client money" does not include money received by you from a client in payment of your bill for work that you have already completed. It also does not include advance payments for costs made to you on terms that have been agreed with your client. This therefore includes advance payments for:
    - your fees prior to your having done the work for your client; and
    - any anticipated disbursements that you are liable to pay to a third party (such as Counsel's fees or foreign filing fees).

7. "Agreeing terms" means that your client:
    - fully understands what they are paying for in advance and the scope and nature of the work that you will do for them. You should explain that they are paying you in advance for your costs which are made up of your fees (i.e. your own charges for specific work which you will perform for them in the future) and, if relevant, for disbursements (that you will pay in the future on their behalf). Your fees could be a fixed fee (i.e. one that will not go up or down) or it could be an estimate for your likely fees for completing that piece of work. Due to the uncertain nature and length of certain aspects of the legal work you may be asked to undertake (for example, drafting a patent application) you may decide to agree terms with your client where any such advance payments are made in a number of stages. This may be more appropriate in a lengthy matter than seeking a larger advance payment to cover the totality of the work; and

- is aware of where their money is being held and the protections that are available to them (rule 4.2 of the Code).

8. In these situations, as you have agreed terms with your client, any such advance payments for costs are not regarded as client money within our definition, and can be paid into your firm's business account. However, to comply with your wider obligations, you should also make sure that you are dealing appropriately with the following risks.

Risks and how you should deal with them

9. There are clear risks to your client if you pay into your firm's business account, money for legal work that you have not yet done or for disbursements that have not yet been incurred. Such risks include, for example, that you fail to complete the work, you fail to pay the disbursement when due, or you or your firm becomes insolvent. In these cases, the client may be left having to pay again for the work. You should therefore always make sure that your client is aware of where their money is being held and the protections that are available to them (Rule 4.2 of the Code). How you do that will depend on the nature of your client and your relationship with them but you should always be mindful of your continuing obligation to act in your clients' best interests and to provide a proper standard of work to them. You should take more care to make an individual or less sophisticated small business consumer aware of these issues and you will need to have regard to their reasonably apparent or expected level of understanding of the risks and issues involved.

10. If your client has paid you money in advance for disbursements, we expect you to make sure that you pay those disbursements promptly as they become due. We suggest that you should also consider letting your client know when such disbursements, especially if for a significant amount, have been paid.

11. You should return to your client promptly any money that you hold and which is due to them by way of a refund as a result of, for example:

- the anticipated work not being carried out by you or the third party, (e.g. if the client withdraws their instructions);
- you over-estimating your fees;
- the disbursement being paid to a third party agency (such as the European Patent office) by you on behalf of your client exceeds the actual cost charged by that agency, resulting in a refund to the firm (usually via the mechanism of a refund to the firm's deposit account with that agency). In appropriate situations, you may use any such refund to offset your fees provided you have your client's prior written consent to do this.

12. You will also need to consider the tax, and in particular VAT implications of having advance money in your firm's business account when you have not yet rendered any services to your client. We are not requiring you to render a bill for any such advance payments for your costs, although you may choose to do this. In all cases, however, you will need to provide clear, written information to your client on the likely fees and disbursements and should be prepared to justify to us why such amounts have been requested in advance, for example, should we receive a complaint in the future.

Use of a Third Party Managed Account – rule 4.3

13. A third party managed account (TPMA) is an account held at a bank or building society in the name of a third party where the third party is regulated by the Financial Conduct Authority (FCA) as:

- an authorised payment institution; or
- a small payment institution that has chosen to implement safeguarding arrangements to the same level as the authorised payment institution.

14. Money in a TPMA is owned beneficially by the third party. The account operates on terms agreed between the third party, the client and you and your firm (as the service provider) as an escrow payment service.

15. Because the money is held by a third party it does not fall within the definition of client money in our rules, but it is important to recognise that it is not the firm's money either.

16. Using a TPMA does not release you or your firm from the requirement to act in the best interests of your clients and other relevant obligations in our Principles and Codes. You should always be mindful of your wider obligations as set out in rule 1.1 of the Code of Conduct – that clients receive the best available information about your work and costs so they can make informed decisions about the services they need, how their work will be handled and the options available to them. In particular, you should take reasonable steps to ensure that the decision to use a TPMA, and the TPMA provider used, is appropriate in the circumstances of each individual case and is in the client's best interests. This may include satisfying yourself that the TPMA provider is authorised by the FCA and is in good standing with them. You can check the authorisation status of a potential provider by searching the Financial Services Register. You may also want to check that the provider has appropriate insurance in place, the terms and conditions of which are not materially prejudicial to clients.

17. If you choose to use a TPMA, you must make sure that your client is informed of, and made aware of, the contractual arrangements. This includes prior to engagement or if the TPMA is suggested during the course of your engagement, then at that point and as the work progresses. You should make sure that your client understands:

- whether any fees are payable for the use of the TPMA, how much they are and who is responsible for paying them.
- their right to terminate the arrangement
- when money may be withdrawn by the client and when money may be paid to you.

18. Where a TPMA is being used, you should maintain an overview of the transactions on the account and keep appropriate records to reflect this.

Notification of the holding of client money (rule 4.4)

19. On annual renewal of your registration, we will ask you to confirm whether you have held client money at any point during the preceding 12 months and will ask you to provide some information about amounts held. We will request this information so we can monitor risks to client money and the adequacy of our compensation fund arrangements. We no longer set any maximum amount of client money that can be held at any one time, but we may introduce guidance or rules around maximum amounts that may be held, if the evidence shows this is necessary.

20. We will also ask you to confirm if you have used a TPMA during the preceding 12 months and if so, the name of the entity used.

Payment of residual balances out of client account; money that cannot be returned to the client : rule 4.5

21. We expect you always to return promptly to your client any money belonging to them or to which they are otherwise entitled, in particular when the matter on which you are instructed has concluded.

22. However we appreciate that on occasion, you may find yourself holding money that you are unable to return to your client. These are sometimes called "residual balances". These are sums of money belonging to clients that are held by you and which you have taken reasonable steps to return to the clients but have been unable to do so. Any such residual balances will usually be aged balances held in the separate bank account that you use to hold client money.

23. In order to comply with your obligation to act in your client's best interests, you should always take reasonable steps to return any such surplus money to your client. If having done this, you are still unable to return the client's money, there are circumstances in which you can pay these residual balances to a charity of your choice, registered with the Charity Commission. What is not permissible is for you to seek to 'sweep up' any such residual balances by preparing a bill for work that has not been done or it otherwise not justifiable.

24. We set out below the approach you should take in accordance with the thresholds that we have prescribed, currently for amounts below and above £500.

Residual balances of less than £500

25. We expect you to take reasonable efforts to locate the client so that you can repay the surplus money to them. What is reasonable in the circumstances will depend on the amount of money held, its age and size and nature of the client. We would expect greater effort to be made for an individual client for whom you are holding surplus money of £450 than we would for the sum of £20 due to a large corporate client. If the client cannot be traced or the cost and effort of doing so is unreasonable (by which we mean disproportionate in all the circumstances) and if the residual balance is less than £500, you can proceed to pay the money to a registered charity of your choice. You do not need to be notify IPReg in advance of using the residual balance in this way.

Residual balances of more than £500

26. If the residual balance is more than £500, you must first seek our permission to your paying the money to a registered charity of your choice. You should do this in writing by contacting us through your IPReg account. We would expect you to be able to demonstrate to us that you have made reasonable efforts to locate your client using steps that are proportionate to the amount of money held, its age and size and nature of the client. Such steps would normally consider include one or more of:

- searching Companies House and/or the Probate Registry
- employing a tracing agent or investigator to help trace the client
- use of social media and newspapers
- placing an advertisement in an appropriate publication .

27. In all situations, we expect you to make and retain appropriate records of any such payments for a reasonable period, including brief details of the enquiries that you have made. There is always the possibility that your client later contacts you asking for payment and you may be asked to explain the steps that you have taken.

Version	Date	Author	Rationale
V1.0	24.3.23	IPReg	Submitted with LSB application