

Financial Regulation of Solicitors

Law Society Responsibilities

There are approximately 2,200 solicitor's practices in the Republic of Ireland. With the exception of 50-100 the majority of those practices will hold client funds on behalf of their clients. The objective of the financial regulation department is the protection of the moneys held in solicitors' client accounts. The Law Society's responsibilities are to

- Protect the public
- Protect clients' interests; in particular clients' moneys
- To protect the reputation of the Legal profession
- To build and maintain confidence in the Regulatory system for solicitors.

The most tangible measure of the Law Society's responsibilities is the objective to minimise claims on the Law Society's compensation fund.

Compensation Fund

The Compensation fund is a statutory fund set up under Section 21 of the Solicitors Amendment Act 1960 as amended by the substitution of Section 29 of the 1994 Act. Under the legislation where it's proved to the satisfaction of the Society that any client of a solicitor has sustained loss in consequence of dishonesty on the part of the solicitor, or any clerk or servant of that solicitor, arising from that solicitor's practice as a solicitor within the jurisdiction of the state, then subject to the provisions of the Act, the Society shall make a grant to that client out of the fund. The key points to remember is that in order to qualify for a grant from the Fund, you must

- be a client of the solicitor
- have sustained a loss in consequence of dishonesty on the part of the solicitor
- have a loss that arises out of the solicitor's practice as a solicitor

Why are claims refused?

Many claims are refused on the basis that they don't arise from the solicitor's practice. They may arise from activities which the solicitor conducts outside his practice, for example, property development. Another key point is that that it must be on foot of dishonesty. Solicitors are required to maintain Professional Indemnity Insurance to cover any client who suffers the loss from negligence. Accordingly the fund won't cover negligence. It must be a client; it cannot be a third party.

State of the fund

The Compensation Fund currently holds approx. €18,000,000 in net assets, each solicitor annually contributes €760 to that fund. The maximum claim is €700,000 per client.

Claims on the fund

The Society's experience of the larger claims on the compensation fund is that they arise from

- unauthorised withdrawals from client accounts,
- stamp duty not paid over to the revenue,
- The discovery that beneficiaries to an estate have not been paid.
- Charities or religious institutions have not been paid.
- Capital acquisitions tax or capital gains tax may not be paid over to the Revenue.
- Registration fees are often a common component of claims.
- Proceeds of the sale of property or the full amount of a settlement has that not been paid over to clients.
- Moneys given to solicitors to hold in matrimonial cases or where solicitors are asked by clients to hold moneys, pending further investment opportunities.

In many of these cases the solicitor has used the money for his own benefit. This has given rise to claims on the Law Society's Compensation Fund.

Why do solicitors steal client moneys?

There are many reasons why solicitors steal client moneys. However usually it is due to insufficient income to support a practice or support the lifestyle to which the solicitor has become accustomed. Very often solicitors are under financial pressure as a result of personal borrowings arising from outside interests, for example property or other businesses or stock market investments. Solicitors have been known to dip into the client account in order to pay the Professional Indemnity Insurance premium. In some cases it has been to pay claims where the insurance policy wouldn't cover those claims. When stamp duty interest and penalties were quite high, a lot of solicitors found themselves in situations where they personally had to pay off interest and penalties on unstamped deeds. This gave rise to misappropriation from the client account.

We have also seen solicitors who have been victims of crime. We have seen one solicitor who was a victim of a Nigerian scam. Another solicitor has been caught by gambling. As you are aware gambling is a growing problem in society in general, and solicitors are in a unique position in that they have access to client moneys.

However, a lot of claims arise because solicitors are unable to make a living. This leads to depression, alcohol problems, drugs, marital breakdown. All these factors contribute to solicitors stealing client's money.

Regulations to protect clients.

In order to protect clients' money the Law Society enforces legislation. Prior to December 1 2014 the relevant statutory instrument was the Solicitor's Accounts Regulations 2001,2005,2006,2013

and Solicitors' Interests on Client Moneys Regulations 2004. Since December 2014, the Society has consolidated all of those statutory instruments into one statutory instrument called the Solicitor's Accounts Regulations 2014. Other legislation to protect clients includes Section 68 of the Solicitor's Amendment Act 1994, the Criminal Justice (Money Laundering and Terrorist Financing) Act 2010-2013. The regulations not only cover the accounting obligations of solicitors but also cover misconduct disclosed by the accounting records. Misconduct could include misleading third parties, mortgage fraud, insurance fraud etc.

Law Society's Regulatory Framework

Regulation of Practice Committee

The regulatory framework within which the Law Society operates includes the Regulation Department, the head of which is the Registrar of Solicitors. In relation to financial regulation department, there is a team of 10 investigating accountants, which are based all over the country. There is one based in Cork, one in Limerick, one in Galway, one in the North West, and the balance operate around the Dublin and Leinster area. The Regulation Department reports to the Regulation of Practice Committee. The Regulation of Practice Committee sits in four divisions. It is made up of solicitors and lay members; currently the makeup of the committee is majority solicitor, with one lay member on each division. There are about six members on each division. This committee meets approximately 7 times a year. However where the circumstances arise, emergency meetings can be held to deal with emergency situations.

Other committees

By way of background, the Law Society also has a Complaint and Client Relations Committee, Professional Indemnity Committee, Money Laundering Reporting Committee. The Complaints and Client Relations Committee will move now to the Legal Services Regulatory when the Legal Services Regulation Act is commenced.

High Court & Disciplinary Tribunal

In addition to the Regulation of Practice Committee the committee will refer matters to the President of the High Court where there is concern about public protection of client moneys and client files. Matters are also referred to a Solicitor's Disciplinary Tribunal which is an independent tribunal. Under the Legal Services Regulatory Act a new independent Solicitors Disciplinary Tribunal will be set up. All the decisions of the tribunal, particularly serious decisions, such as suspension of practice certificate or strike off are referred to the President of the High Court who has the ultimate say in whether a solicitor is removed from the Roll of Solicitors or not.

Legislation

The legislation most referred to by the Regulation of Practice Committee includes the following

- Section 19 of the 1960 Act as amended by Section 27 of the 1994 Solicitors (Amendment) Act. That gives the Law Society power to take up files.
- Section 20 of the 1960 act as amended by Section 28 of the 1994 Act gives the Society authority to take control of solicitor's bank accounts and assets. In effect these are freezing

orders. They are very draconian powers which are available to the Law Society which are only exercised in exceptional circumstances. Where it is clear to the Society that in order to protect the public, in particular client moneys and client files, the Society will apply to the President of the High Court for an Order to take up the files and the client moneys of the practice.

- Under Section 58 of the 1994 Act the Society also has the power to apply to the High Court to suspend a solicitor's Practising Certificate, and may do so in circumstances where it believes it is in the best interest of the public to do so.
- Under Section 59 of the 1994 Act, impose conditions on a practising certificate. A common occurrence would be for the Law Society to require a second signatory on the solicitor's client account where it is felt that the solicitor needed supervision in relation to the handling of client moneys.
- Under Section 61 of the 1954 Act, which gives the Society the power to intervene in a practice where a Solicitor has died and there is no provision for dealing with client's affairs, or a solicitor may be incapacitated due to health problems. The Society will only exercise those powers in circumstances where it is absolutely necessary to do so.
- Section 68 of the 1994 Act. The Law Society enforces Section 68 which will be replaced now by Section 150 of the Legal Services Regulation Act, which deals with charges to clients and solicitors adopting appropriate procedures in relation to clients.
- Under the Solicitors Accounts Regulations 2014 the Society can recover the costs of the investigation where there are material breaches of the Regulations. The Society is the designated body under Section 63 of the Criminal Justice (Money Laundering and Terrorist Financing) Act 2010 and the Society has an obligation to report any suspicion of money laundering by a solicitor or indeed by a third party.
- Under Section 19 of the Criminal Justice Act, the Society has an obligation to report any suspicion of the crimes scheduled in that Act.
- Regulation 35(6) under the Solicitor's Accounts Regulations the Society has the power to refer a solicitor to the Solicitors Disciplinary Tribunal.

Solicitors Accounts Regulations

What follows is an extremely skeleton description of the Solicitors Accounts Regulations, as they apply to solicitors. Similar regulations apply in relation to trust accounts, in relation to insolvency arrangement accounts.

- Solicitors Accounts Regulations require solicitors to pay client money into a client account, held in a licenced bank situated in the state. It is a requirement that the bank into which the money is paid is a licenced bank and is a bank or has a branch situation in the state. If the Law Society have to freeze the bank accounts, it is important that they are held within the jurisdiction of the state.
- Solicitors are required to keep office moneys and personal moneys out of client account. It is very important that client moneys are kept separate from office moneys, and from personal moneys.
- There are very limited circumstances in which a solicitor can withdraw money from a client account. Where withdrawal of moneys takes place it must be properly required in payment

to or on behalf of clients. It has to be to pay money to or on behalf of clients, or to apply it in satisfaction of fees. It may also be required towards payment due to solicitor in respect of outlays disbursed by that solicitor in the course of providing the legal service.

- The Regulations require the solicitor to make it clear to clients that moneys held are or will be applied in satisfaction of fees. The moneys must be transferred in a timely basis.
- Solicitors have an obligation to account to clients for interest of client moneys. It would be very cumbersome for a solicitor to account for interest on all transactions, so there is a threshold of €100; that is the amount that a solicitor would earn had he/she placed the money in a separate deposit account. If the interest earned is less than €100, then the solicitor does not have to account to the client for interest.
- The solicitor is required under the Regulations to open an office account and pay all fees into the office account. They may pay them into the client account and then transfer them to the office account.
- It is a breach of the Regulations to transfer fees from clients' accounts to personal accounts.
- The Regulations also require a solicitor to furnish a client with a bill of costs that specifies the professional fees, so it isn't a case that money can indefinitely remain in a client account, or a solicitor can avoid having to transfer money by not providing a client with a bill of costs.
- A solicitor must maintain proper books of accounts at all times, in particular client and office ledgers, and prepare monthly balancing statements at a minimum 6 monthly intervals in order to ensure the accuracy of those books of account.

Aspects of the Regulations worth nothing include

- Undisclosed outlays are client moneys.
- Solicitors have 3 months to withdraw money to which they are beneficially entitled.
- Mixed money may be lodged to client accounts. Insolvency arrangement money cannot.
- Lender cheques can be endorsed and paid over to third parties provided adequate documentation on file.
- Debit balances are prohibited and must be rectified.
- The Society won't allow a solicitor to practice with a deficit.
- Interest on general client deposit account is not client money.
- Proper books of account are required at all times and such relevant supporting documentation as to enable client money to be recorded and vouched.
- Returned paid cheques must be obtained.
- A solicitor cannot lodge an unendorsed cheque.

Monitoring Compliance – Accountants Reports

In order to monitor compliance with the Solicitors Accounts Regulations, solicitors must furnish to the Society an annual accountants report which contains the opinion of the Reporting Accountant as to the solicitor's compliance with the regulations. The report includes a balancing statement setting out the gross liabilities as shown by ledger account balances in respect of clients, controlled trust and insolvency arrangements, the balance of control accounts and the total moneys held in client accounts, trust accounts, insolvency arrangement accounts. Any matters in respect of which

the solicitor has not complied with the regulations are specified in the report, and that report is signed by the solicitor or compliance partner within the firm. The Law Society relies on these reports and examines them carefully. Disciplinary action is taken if they are not filed on time.

Law Society Inspections

In addition to the accountants report the Law Society itself monitors compliance with the regulations through an inspection regime. The Law Society inspect the books of account of solicitor's practices for the purposes of investigating whether there has been due compliance with the Solicitors Accounts Regulations, and it also uses those inspections to look for compliance with Anti Money Laundering obligations. The investigating accountant also looks for any other misconduct disclosed by the accounting records.

The Society carries out random and targeted inspections. Random inspections may result in a new firm getting an inspection after about 3 years, and a firm can expect an inspection 5 years thereafter.

However in recent years because of claims on the compensation fund, to reduce the risk to the fund, the Society has carried out targeted inspections. They are very often caused by the receipt of qualified accountants reports, complaints, the results of previous Law Society inspections, judgement debts, expressions of concern by other members of the profession or members of the public. If the Society are aware of Professional Indemnity Insurance issues that could trigger an inspection.

Issues Arising from Inspections

- Solicitors not keeping proper accounting records,
- Taking fees when not authorised to do so – for example taking fees in advance or not providing clients with a bill of costs.
- Solicitors borrowing money from clients, and we have to be very careful there that the clients have agreed to that taking place.
- Solicitors failing to complete stamping and registration, or complete the administration of estates. These practices have to be monitored until the work is done.
- Solicitors keeping personal moneys held in the client account. Very often fees are left undrawn or personal moneys are put into the client account which is a breach of the Regulations.
- Solicitors paying office expenses from the client account, or even paying personal expenses from the client account, all of which is prohibited by the Regulations.
- Solicitors not discharging counsel fees, witnesses' expenses where they are held in the client account.
- Solicitors advancing money from the client account where there isn't sufficient funds held on behalf of a client. Usually it is a mistake, and arises from solicitors not properly checking the books of account. However this gives rise to debit balances, and is a breach of the regulations and has to be rectified.

Section 68

Monitor compliance with Section 68 of the Solicitors Amendment Act to ensure that solicitors provide their clients with sufficient details of charges to their clients on contentious matters.

AML

We also look to see if Solicitors have complied with their Anti Money Laundering obligations, in particular that they are complying with due diligence, and to ascertain whether they have been making reports in relation to suspicious transactions.

Deficits of client account

Our main concern is to ensure that there are no deficits of client funds. We come across deficits that are rectified and unrectified. **The Society will not permit any solicitor to practice with a deficit.**

Other misconduct

We would also be on the lookout for misconduct disclosed by the accounting records, and that could be anything such as misleading clients, misleading third parties, mortgage fraud, money laundering, spurious claims; if we come across anything that is suspicious we have an obligation to report that to the appropriate authorities

History of deficits giving rise to claims of fund

• Year	No. of Solicitors	Dublin	Country	€M
• 2010	(2)	2		2.15
• 2011	(6)	2	4	3.7
• 2012	(5)		5	1.25
• 2013	(4)		4	2.25
• 2014	(2)		2	0.75
• 2015	(2)		2	0.96

Every year we discover at least 2 solicitors who have misappropriated client moneys giving rise to claims on the fund. In 2010 there were 2, giving rise to claims of €2million. In 2011, 6 giving rise to claims of €3.7 million. In 2012, 5 giving rise to claims of €1.25 million. In 2013, 4 giving rise to claims of €2.25 million. In 2014, 2 giving rise to claims of €750,000. In 2015, 2 giving rise to claims of €960,000. At the height of the recession solicitors in Dublin gave rise to claims on the compensation fund. In recent years, the majority of the solicitors in trouble have been outside Dublin.

Inspection activity

In 2015 we conducted around 400 inspections. In 82% of those inspections there were either no problems with the solicitor's accounts or the problems were such that we could deal with them by correspondence. However that left about 18%, which is approx. 74 solicitors,

- 35 of which were called before the Regulation of Practice Committee, no action was taken
- 20 were called before the Regulation of Practice Committee and levied with the cost of the inspection.
- 11 cases we referred solicitors to Disciplinary Tribunals or took High Court action against the solicitors.
- 8 ongoing matters – practices requiring monitoring

There would be a number of ongoing matters where we are monitoring the solicitor rectifying problems that we have discovered in the practice.

Problems detecting dishonesty

It isn't always easy to detect dishonesty. The books of account won't always show the deficit. There could be false or misleading entries in the books of account.

- Transactions deliberately posted to incorrect ledger accounts.
- Undisclosed bank accounts, unauthorised withdrawals.
- We have also encountered falsified files and documents placed in files.
- Clever solicitors can steal large sums of money from a relatively small number of clients, which makes it harder to detect.
- There can also be collusion between solicitors and bookkeepers and third parties to conceal the existence of the deficit.

In general the Law Society does not go directly to clients to verify the transactions. However in recent years we have been reviewing that policy, and we will do so where we consider it necessary or appropriate. However we would be mindful of solicitor/client confidentiality, and would only do that in an exceptional circumstance.

I hope this gives you an overview of the Financial Regulation Department within the Law Society.

Seamus McGrath

Senior Investigating Accountant

Law Society of Ireland.