Third-party funds

A survey amongst civil-law notaries, court bailiffs and solicitors

Summary

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Summary

In the course of their duties civil-law notaries, court bailiffs and solicitors receive money that belongs to third parties. In order to hold such money outside the sphere of control of those professional practitioners various arrangements were made at the end of the 1990s. For civil-law notaries and court bailiffs the third-party funds are strictly separated from the other accounts of the office or the professional by means of (virtually identical) legal regulations. The civil-law notaries and court bailiffs use separate accounts, referred to as designated accounts (kwaliteitsrekeningen), for the third-party funds. For the solicitors there is no legal arrangement. According to the rules of the profession the solicitor is obliged to use a separate third-party funds foundation as legal entity for the third-party funds.

A financial supervision regime and disciplinary regime have been developed for maintenance of the compulsory use of third-party funds accounts. Responsibility for the financial supervision of civil-law notaries and court bailiffs has been assigned to the Financial Supervision Office (BFT - Bureau Financieel Toezicht), while supervision of the legal profession rests with the Dutch Bar Association (Nederlandse Orde van Advocaten). The disciplinary regime has been delegated to the supervisors within each professional group (Supervisory Chambers, Chamber for Court Bailiffs, Deans or Disciplinary Boards - Kamers van Toezicht, Kamer voor Gerechtsdeurwaarders, Dekens of Raden van Discipline).

The practice of the arrangements and regulations with regard to third-party funds and their supervision have developed over the last five years. The justice minister has promised the Lower Chamber of the Dutch Parliament on various occasions that, after a number of years of practical experience, he would evaluate the arrangements. On the basis of this the Scientific Research and Documentation Centre (WODC - Wetenschappelijk Onderzoek- en Documentatiecentrum) of the Ministry of Justice requested the Institute for Examination of Government Expenditure (IOO - Instituut voor Onderzoek van Overheidsuitgaven) to carry out an evaluation study of practical experiences with the legal and professional arrangements regarding the third-party funds accounts.

The evaluation study focuses on the nature and extent of the use of third-party funds accounts and on the usefulness of the arrangements for the professional groups. The study gives a judgement on the extent to which professional practice deviates from the provisions of law. It also focuses on the use of third-party funds accounts and the effectiveness of the supervision.
For the purpose of the evaluation study use has been made of public information from the supervisors with regard to third-party funds, experiences and opinions of Deans have been reviewed and discussions have been held with professional practitioners. In addition, the results of the evaluation study have been based primarily on data obtained from an internet survey of 690 civil-law notaries, court bailiffs and solicitors. This internet survey of a large group of professional practitioners was used to examine what - in the opinions of these professional practitioners - current practice is with regard to the third-party funds accounts.

Nature and scope of the use of third-party funds accounts
All professional practitioners have one or more third-party funds accounts. This is usually a general third-party funds account. This is an account that is used for payments to and from several third parties. In addition, a third of the professional practitioners also have one or more special third-party funds accounts. A special third-party funds account is an account that is intended for one transaction or one specific third party.

Compared with the court bailiffs and the solicitors, the civil-law notaries have the most third-party funds accounts, have the highest quarterly balances in their third-party funds accounts and the amounts per transaction are the highest. The most transactions per year take place in the third-party funds accounts of court bailiffs. Solicitors use the third-party funds account the least. Some solicitors have never used the third-party funds account at all.

Certainly in the legal profession the suspicion has always existed that irregularities with third-party funds were most likely to occur in the case of the professional practitioners working in the smaller offices and in the case of one-man offices. No evidence for this assumption is found in practice. The size of the balances in the third-party funds accounts, the average transaction amount and the role, significance, advantages and disadvantages of the third-party funds accounts do differ according to office size. However, no statistical relationship was found between the reports of negative custody positions in the survey and the office size. Neither does the BFT report of a relationship between the number of findings and the office size in its financial supervision performed at court bailiffs and civil-law notaries.

On the basis of the survey results it has been estimated that in 2005 the nation-wide total of the balances was eight billion euros. Civil-law notaries manage 96% of this amount. In quantitative terms, therefore, civil-law notaries are the major treasurers of third-party funds.
Compliance with the rules

According to the rules civil-law notaries, court bailiffs and solicitors must maintain a third-party funds account for purposes of third-party monies. All professional practitioners in fact do so.

Strict rules and procedures apply to the financial management of the third-party funds accounts. In the case of a significant minority of the professional practitioners the rules are not effectively applied and the immediate correction of errors is given insufficient substance. Despite the fact that negative custody positions, inadequate separation of financial responsibilities, incorrect naming of accounts and incorrect entries are not allowed, the survey results and the findings of the BFT reveal that a small proportion of professional practitioners sometimes take their eye off the ball. The reasons for such omissions are multiple, such as new entrants, mergers and take-overs, ignorance, administrative and accounting carelessness, negligence, limited financial supervision in the legal profession and differences in sanctions policies of the disciplinary bodies within and between the professional groups. The fact that such omissions continue to occur underlines the importance of sound financial supervision and a consistent policy on sanctions.

Neither the implementation of the legal arrangements with the civil-law notaries and the court bailiffs nor the placing of third-party funds in a separate legal entity in the legal profession excludes interweaving of funds flows or incorrect deposits and payments. In practice the separation between third-party funds accounts and office accounts is incomplete.

According to the rules the balance in the third-party funds account must be sufficient to meet the obligations of third parties. According to 4% of the respondents this is not always the case in their office.

According to the rules the offices must take specific measures to guarantee the separation of flows of funds. These measures are: separate organisation of the administrative and accounting processes, regular checking of the adequacy of the balances and a careful procedure regarding postings from the third-party funds account. In fact 37% of the civil-law notaries say that they check the adequacy of the balances in the third-party funds accounts daily or weekly, while this is the case with 32% of the court bailiffs and 14% of the solicitors. In general the solicitors adopt the least precautionary measures in order to guarantee correct use of the third-party funds accounts. In addition, it is they who behave least in the spirit of the rules. In fact 40% of the solicitors say that they do not comply with the requirement to provide two signatures for postings from the third-party funds account in accordance with the guidelines.
In the context of practical compliance with the rules it is found that
regular checks (daily, weekly) are necessary of all payments received
into and made from all accounts. It is important that the financial su-
upervisors exercise express supervision of this. Although negative cus-
tody positions are not the same as fraud, the professional practitioners
in the survey subscribe to the proposition that inadequately separated
funds flows render fraud with and embezzlement of third-party funds
possible.

The practicability of the rules
More than 40% of the professional practitioners have a positive view of
the third-party funds accounts. An even larger proportion of the profes-
sional practitioners name positive benefits of the regulations surround-
ing third-party funds accounts. The benefits indicated by the profes-
sional practitioners have a clear, substantive significance and reinforce
the role of the civil-law notary and court bailiff as public officials and
that of the solicitor as a reliable intermediary. This relates to benefits
named spontaneously by the professional practitioners, such as: guar-
anteeing the interests of clients, reinforcing the position of trust, im-
proving the transparency of the financial management and increasing
the audit possibilities.

A smaller but significant proportion of the respondents express negative
opinions on third-party funds accounts. The objections relate to the high
administrative and accounting burden, the cost of the third-party funds
accounts, the formalities and rules if the office situation changes, com-
plex and unclear regulations and inadequate supervision.

The rules for civil-law notaries and court bailiffs appear to be more
practicable than those for solicitors. We draw this conclusion from the
fact that civil-law notaries and court bailiffs are able to name many
more positive than negative characteristics of third-party funds ac-
counts.

The most criticism is expressed about the administrative and accounting
burden or the additional costs that the third-party funds account en-
tails. This criticism is louder in the case of one-man offices and solici-
tors. Large offices and most offices of civil-law notaries and court bail-
iffs make optimum use of computerised aids, as a result of which they
experience less inconvenience from the administrative and accounting
obligations regarding the financial management of third-party funds ac-
counts. Solicitors find the requirement for a second signature very on-
erous.

Operation of the supervision
The BFT performs the financial supervision of the third-party funds ac-
counts of civil-law notaries and court bailiffs, and the Dutch Bar Asso-
cation and the Deans do so with regard to the third-party funds accounts of solicitors.

The BFT performs regular, systematic monitoring and uses a modern method of risk analysis in order to identify possibly improper use of third-party funds accounts. The results of the financial supervision are reported systematically in the BFT’s quarterly and annual reports. The civil-law notaries and court bailiffs questioned confirm the fact that they are checked regularly and also report received findings from the BFT. Generally a BFT finding results in appropriate measures by the professional practitioner.

In the case of solicitors the financial supervision is less systematic, analytical and transparent. Solicitors are hardly monitored: the respondents report few if any checks or observations and the Bar Association and Deans can scarcely if at all show the results of the checks. It is notable therefore that only a very limited number of solicitors have been subject to disciplinary sanctions as a result of failure to apply the second signature.

The effectiveness of the financial supervision depends in part on the sanctions that have been applied after lapses have been identified and reported to the Disciplinary Boards, Chamber for Court Bailiffs or Deans (Kamers van Toezicht, Kamer voor Gerechtsdeurwaarders or Dekens). Such sanctioning takes place with too much delay and too little consistency, according to the responding civil-law notaries and court bailiffs. With respect to the legal profession it is not known at all whether checks have been made, in which cases there have been sanctions and what the results of those sanctions have been.

Possible changes to financial supervision

Operation of second signature not as envisaged
Introduction of the second signature in the legal profession was intended to incorporate an additional barrier against misuse of third-party funds. The large-scale enquiry in the survey of practice reveals that in the case of a very large proportion of the professional practitioners this envisaged effect is hardly occurring if at all. The Bar Association could take steps to give more robust content to the financial supervision of improper use of third-party funds.

Reinforcement of preventive supervision
In the legal profession and in the case of the court bailiffs the preventive supervision is less well-developed than in the case of the notarial profession. In the legal profession completely new provisions and procedures are necessary in order to reinforce the preventive supervision. For court bailiffs the practice of the notarial profession can be followed
by increasing the number of instruments for the BFT (chairman’s talks, findings).

Supervision has its price
The costs and administrative and accounting burdens of financial supervision in the legal profession are borne in full by professional practitioners themselves. In the notarial profession and in the case of the court bailiffs the financial supervision is funded by government via the BFT. What method is preferable was not determined in the survey of practice.

In addition, it has to be taken into consideration that reinforcement of the financial supervision increases the administrative and accounting burdens for the professional practitioners and for the offices and can impede new entrants.

The costs of reinforcing financial supervision must be weighed against the unknown benefits (reduction of government liability risks, less damage to client confidence and reputation). This consideration should take place in the knowledge that in recent years there have been hardly any major disasters with third-party funds.

Tightening up, standardising and coordinating disciplinary proceedings
Disciplinary proceedings are fragmented and relatively inconsistent. In addition, many people believe that the speed and alertness of action leave something to be desired. It is therefore advisable to improve the disciplinary proceedings in the notarial and legal professions. The situation with regard to court bailiffs is not fragmented. For them there is only one Chamber of Court Bailiffs (Kamer voor Gerechtsdeurwaarders). It is possible, however, to reinforce the preventive supervision and to apply disciplinary proceedings consistently and more quickly.

More transparent supervision, better information for purposes of analysis
As most supervisors do not maintain an overview of the complaints they receive, it is not possible to obtain an overall picture of the nature and extent of the complaints. In addition, it is impossible to quantify the financial and other risks that are incurred as the result of current professional practice. Moreover the information held by the BFT and the Bar Association is hardly if at all suitable for the statistical analysis of practice regarding third-party funds accounts. The supervision is organised on a case by case basis. The information is not organised for summary studies or statistical analysis.
The same conclusion can be drawn with regard to disciplinary judgements. Here too, information is found to be unavailable or only partially available and the data are unsuitable for statistical analysis. In the meantime the Bar Association has been informed by the Justice Minister that it would be desirable for a central disciplinary register to be developed. This would make it more possible in the future to show the results of the financial supervision with regard to third-party funds accounts.