Risk Management Matters

Winter 2020/21

Willis Towers Watson

Risk Management Matters

Welcome to our Winter 2020/21 edition

One year ago, when we published the Winter 2020 Risk Management Matters brochure, we could not have conceived the significant changes that we would all have to make to our working lives and the restrictions that we would be operating under. For all of us, our methods and styles of working have changed considerably since the initial lock-down in March 2020.

Coronavirus (COVID-19) may have been the main area of focus last year, but as we move into 2021 there are other events on the horizon which will no doubt be on your compliance and risk management agendas. The new trading agreement with the EU will see impacts to the movement of goods and services, and protection of data, whilst the Stamp Duty Land Tax holiday will end in March 2021. For insurance buyers, the Lloyds review of cyber insurance will be felt for firms whose professional indemnity insurance renews after 1 January 2021. It is also important to mention the risk of money laundering, which continues to impact on our society and economy as the latest National Risk Assessment makes clear.

Beyond these new or changing areas, the traditional risks continue. Obviously, there is still a need to maintain the high standards that clients and the regulator expect, and we consider these in the article on service standards.

Several firms have asked us about capping liability in recent months and we look at methods of capping or limiting liability whilst staying compliant with the Solicitors Regulation Authority.

We hope that this brochure provides you with some useful content to consider your own risk management approach.

Should you have any other risk matters on your agenda, or if you need help with the placement of your professional indemnity insurance policies that you would like to be addressed, then please do let us know.

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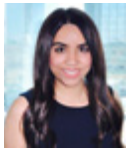

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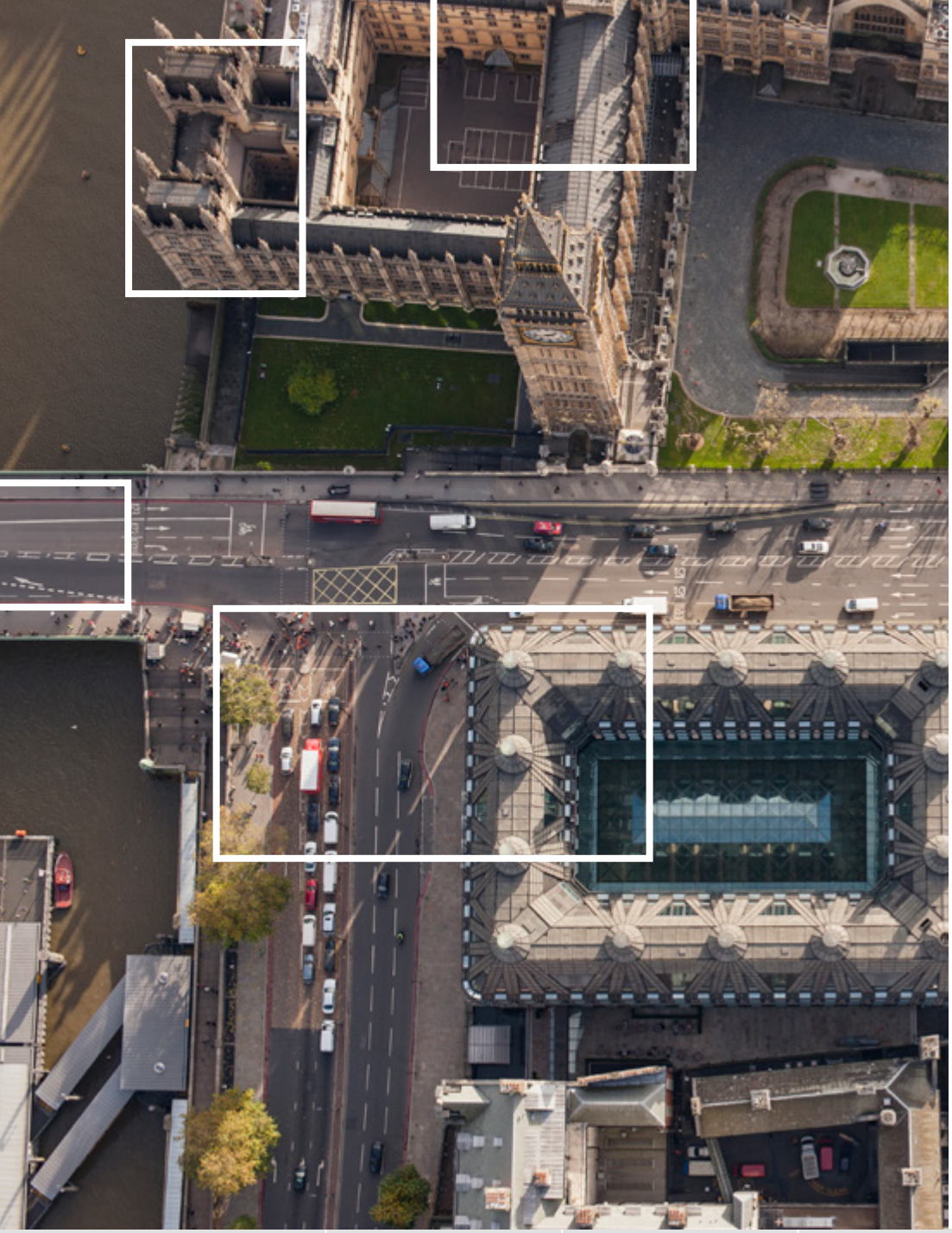


How Brexit has changed DAC6

By Joanne Cracknell

Introduction

The pre-Christmas UK and EU Trade and Co-operation Agreement[1] (the Agreement) has meant significant changes in the UK's approach to cross border tax avoidance and specifically DAC6 (Directive on Administrative Co-operation).

Rather than implement DAC6 in its entirety, the scope has significantly narrowed, and the UK will now apply the OECD Mandatory Disclosures Rules[2] instead. In this update we look at what these changes mean for your business and how your reporting requirements have changed.

What is DAC6?

We have written about DAC6 previously, initially concerning the implementation[3] and then secondly when the reporting requirements were delayed[4]. Broadly DAC6 is a requirement on service providers and intermediaries to report cross border tax arrangements that bear the hallmarks of tax evasion schemes, at an EU level.

The first reporting obligations should have been made with effect from **31 January 2021**. Although the more onerous requirement was surely the identification of any cross-border arrangements where the first step was taken during **25 June 2018** and **30 June 2020**.

1. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/948119/EU-UK_Trade_and_Cooperation_Agreement_24.12.2020.pdf
2. https://www.oecd.org/tax/model-mandatory-disclosure-rules-for-crs-avoidance-arrangements-and-opaque-offshore-structures.htm
3. https://www.willistowerswatson.com/en-GB/Insights/2020/05/dac-6-and-enhancing-tax-transparency
4. https://www.willistowerswatson.com/en-GB/Insights/2020/07/dac-6-reporting-timescales-delayed-for-6-months

What has changed?

Rather than implement DAC6 in its entirety, the scope has significantly narrowed, and the UK will now apply the OECD Mandatory Disclosures Rules instead. What this means is that only arrangements that would have fallen under category D of Part II of the Annex to DAC6[5] now need to be reported.

The OECD Mandatory Disclosure Rules have some crossover with the DAC6 legislation, but basically all the reporting requirements under categories A, B, C and E have now been omitted[6]. This reduces the reporting requirements significantly for service providers and intermediaries. Only arrangements under category D now need to be reported.

What has not changed?

Arrangements that fall under category D will still be required to be reported. Category D events are those that undermine reporting obligations under the Common Reporting Standards (CRS), or involve non-transparent ownership claims, to a large extent this mirrors requirements under Anti-Money Laundering legislation.

Specifically, this includes:-

- Arrangements which have the effect of undermining reporting requirements under agreements for the automatic exchange of information
- Arrangements which obscure beneficial ownership and involve the use of offshore entities and structures with no real substance

This may seem very similar to Anti-Money Laundering legislation and checks that are already in place, especially when dealing with trusts, undisclosed owners or shareholders, or jurisdictions where there is no requirement to document or keep ownership information.

Are there any examples of Category D hallmarks?

HMRC provides some examples of what might and what might not constitute a requirement to report[7]. Requirements to report might include:-

- A transaction that would be uncommercial but for the benefit of avoiding CRS reporting
- Complicated ownership structures, or ownership structures that are just below the reporting threshold
- Non-transparent clients, or those who cannot provide an explanation for a transaction or structure

5. https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32018L0822
6. https://www.legislation.gov.uk/uksi/2020/1649/regulation/2/made
7. https://www.gov.uk/hmrc-internal-manuals/international-exchange-of-information/ieim645010

What happens next?

The UK's current approach is expected to be replaced with legislation that implements reporting in line with the OECD's Mandatory Disclosures Rules. Until then though firms need to continue to comply with the amended regulations.

Firms need to report only on category D hallmarks until this legislation is enacted. This means the reporting deadlines are now:-

Do we need to consider anything else?

Firms should be aware that under the Disclosure of Tax Avoidance Schemes Rules (DOTAS), there remains a requirement to report to HMRC[8].

Arrangements that are cross border between the UK and EU and bear one of the hallmarks that are now no-longer applied under UK legislation may now need to be reported to an EU member state's tax authority. It is recommended that tax law experts are consulted in this respect.

8. https://www.gov.uk/guidance/disclosure-of-tax-avoidance-schemes-overview

Conclusion

The Agreement may have reduced the reporting obligations on UK firms, but it has not entirely removed that obligation. Reporting on category D hallmarks needs to continue, and consideration within those reports also needs to be given as to whether DOTAS applies, as well as considering whether there is a requirement to report under the other hallmarks to an EU member states tax authority.

If you have any concerns over your reporting obligations in respect of DAC6 and category D hallmarks then we would be pleased to discuss.

Stamp duty - the holiday is nearly over

By Joanne Cracknell

In July 2020 the UK Government announced a temporary cut in Stamp Duty Land Tax meaning Stamp Duty will only be paid for amounts over £500,000 until 31 March this year. As we approach the end of the relief period, we consider some of the possible consequences for law firms and their clients.

Background

The Stamp Duty holiday was introduced to keep the economy moving and kick start the housing market following the first national lock-down as a result of the coronavirus pandemic. Certainly, since then, conveyancing workloads have increased, in part due to the holiday but also perhaps resulting from pent up demand and changing lifestyles.

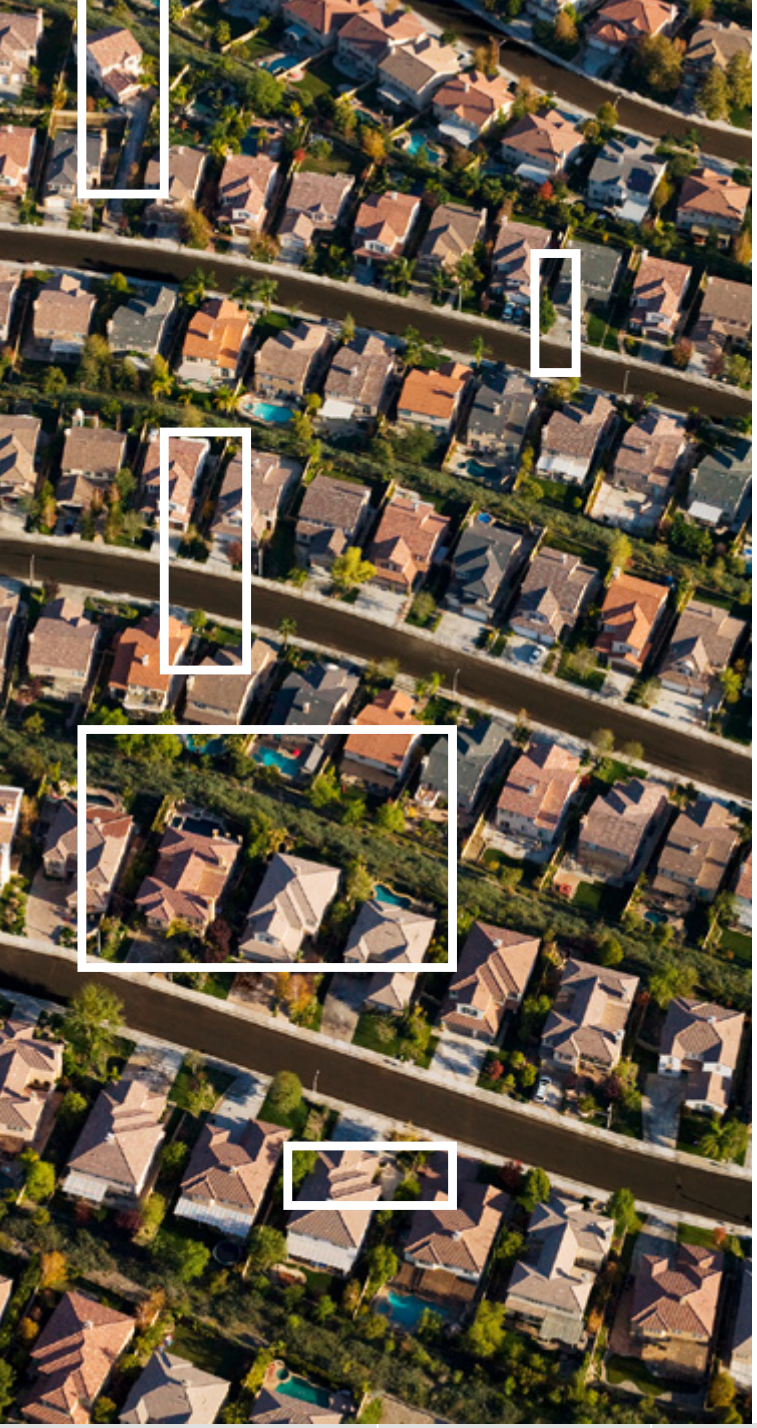
Unsurprisingly, people looking to move prior to the holiday show no signs of abating with "Todays Conveyancer" headlines claiming 2021 as the 'Busiest ever start to the year'[1].

Will the deadline be extended?

There have been calls to extend the Stamp Duty holiday, but at the time of writing the UK Government has rejected those calls[2], stating: -

The Stamp Duty holiday was designed to be a temporary relief to stimulate market activity and support jobs that rely on the property market. The Government does not plan to extend this temporary relief.

1. https://www.todaysconveyancer.co.uk/main-news/busiest-ever-start-year-home-hunters-seek-new-year-moves/
2. https://petition.parliament.uk/petitions/550545



What will happen on 31 March 2021?

Simply put any transaction that has not completed, even if exchange has occurred, will carry the rates that were in place prior to 8 July 2020.

Buyers will be liable for payment of Stamp Duty if their purchase is over £125,000 (although it should be noted that first time buyers attract lower rates).

It is also worth noting that the additional 2% tax on purchases by foreign buyers will come into effect on 1 April 2021 and that the current Help To Buy scheme is due to end on 31 March 2021[3]. Clients that will be impacted by these changes must be made aware.

Keeping clients informed

As we rapidly approach the deadline, clients need to be informed if their purchase is unlikely to complete before 31 March 2021 and so benefit from the holiday.

The process of purchasing a property is a complicated one under normal circumstances, but during restrictions on travel and human interaction typical issues have been exacerbated and led to further delays. Reduced staff, due to furlough or illness, and increased workloads for search providers, local authorities, surveyors or conveyancing teams themselves have inevitably led to further delays.

It is not difficult to foresee that buyers who miss the deadline may abort the transaction altogether or complain to the conveyancer about delays in the process.

Complaints

In September 2020 the Legal Ombudsman (LeO) identified those who missed out on the Stamp Duty holiday as a possible source of complaint[4]. Residential conveyancing has consistently been the most complained about practice area in LeO reports, with 28% of complaints in the 2019/20[5] report and of those complaints the majority relate to delays, poor communication and failure to progress. It is anticipated that it is these categories of complaints which could arguably be made by clients who miss out on the Stamp Duty holiday.

As ever, even an unjustified complaint can take up considerable management resource and time to resolve and add to already busy workloads.

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3. https://www.gov.uk/government/publications/new-rates-of-stamp-duty-land-tax-for-non-uk-residents-from-1-april-2021
4. https://www.legalombudsman.org.uk/media/t2jfhjs1/107-14-20-horizon-scan.pdf
5. https://www.legalombudsman.org.uk/media/vcrpshl4/200924-overview-of-complaint-summary-final.pdf

Managing client's expectations

Keeping clients informed and updated on progress under any circumstances is good customer service, but the financial implications for the client of missing the 31 March 2021 Stamp Duty holiday deadline make the requirement of keeping clients informed all the more important.

Firms should ensure they: -

- Keep clients fully advised and updated on progress and of the implications of not meeting the deadline
- Provide quotes to include the full Stamp Duty payment on the basis that the purchase is unlikely to complete before the deadline
- Ensure that all advice to clients or potential clients accurately reflects the current state of the market. Firms will be aware that under the SRA Transparency Rules[6] there is a requirement to provide 'likely timescales'. It is recommended that those timescales are reviewed and updated and communicated to clients to ensure that they accurately reflect the current situation

Conclusion

The Stamp Duty holiday was launched to kick start the housing market amongst a wave of optimism and goodwill at the beginning of the pandemic. It clearly had a positive impact on transactions, but as the deadline grows nearer pressure on law firms and others involved in the process is increasing.

Clearly some transactions will not complete in time, and those purchasers may then be faced with an unexpected bill. This may well be the source of complaints to law firms and others involved in the process. Taking steps to manage the expectations of clients now and keeping them fully informed of delays and the impact of those delays should help to reduce or respond to such complaints or potential claims.

6. https://www.sra.org.uk/solicitors/standards-regulations/transparency-rules/

Maintaining service standards in turbulent times

By Joanne Cracknell

As we march into the New Year with hope and a little trepidation of what 2021 may bring, what remains consistent is the need for law firms to meet their obligations to provide high quality legal services.

The Solicitors Regulation Authority (SRA) recently published its Risk Outlook Report[1] and Standards of Service continues to be listed as key risk and challenge faced by the legal profession[2].

This article concentrates on the issue of service standards, what the current concerns are and how standards can be maintained and improved.

A client's right to complain

Law firms should routinely provide a good and timely level of client service taking into consideration the clients' needs and circumstances. If a client is dissatisfied with the service they receive from their solicitor, they have a right to complain, either directly to the solicitor in the first instance, i.e. a First Tier Complaint (FTC), or to the Legal Ombudsman (LeO) if the complaint cannot be resolved to the client's satisfaction. LeO will not provide legal advice and will not consider whether the advice provided by the solicitor was incorrect. LeO's role is to advise the law firm how to resolve a complaint if there is evidence of poor service, and it can offer a range of remedies which include:-

1. Solicitors Regulation Authority. (2021). Risk Outlook 2020/2021. Retrieved from the Solicitors Regulation Authority website: https://www.sra.org.uk/risk/outlook/risk-outlook-2020-21/
2. Solicitors Regulation Authority. (2021). Standards of Service. Retrieved from the Solicitors Regulation Authority website: https://www.sra.org.uk/risk/outlook/risk-outlook-2020-21/standards-of-service/

The SRA will also receive complaints directly from clients. If such complaints relate to service issues, they can be referred to LeO to investigate and resolve. Complaints relating to negligence or misconduct will be dealt with by the law firm's professional indemnity insurers and the SRA respectively.

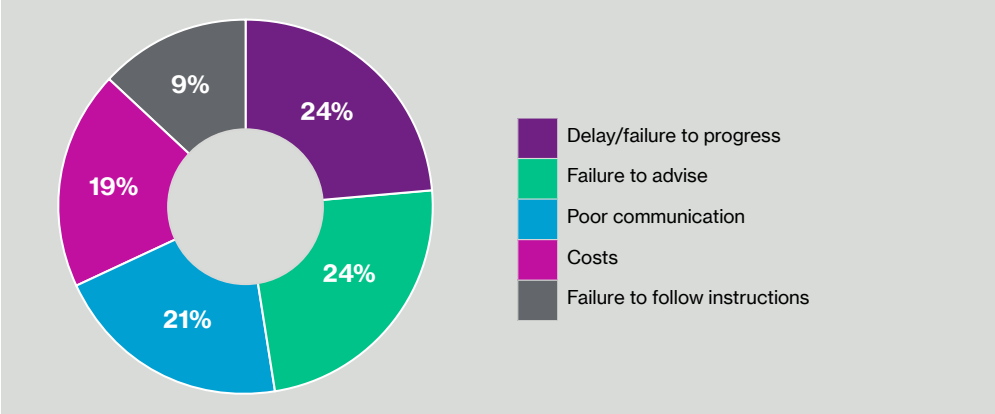
Types of complaints

The common themes and types of complaints made over the years have remained consistent. The SRA's Risk Outlook report states that a high proportion of the reports received concern inadequate client care, such as delays and poor communication, which is supported by the findings in the annual SRA First Tier Complaints report published in July 2020[3].

The report compares complaint volumes against previous years as well as the rate of resolution. This information can be used and interpreted by law firms to enable them to improve their own procedures and practices, which will in the long term improve the way complaints are handled and resolved.

LeO also publishes an annual report which reviews complaints data[4]. During 2019/2020 LeO accepted 6,425 new complaints, resolving 6,384 of them. 51% of those complaints LeO found 'unreasonable service'. We summarise some of the key findings in the pie graph below.

Most common cause of complaints law firms receive according to the LeO report

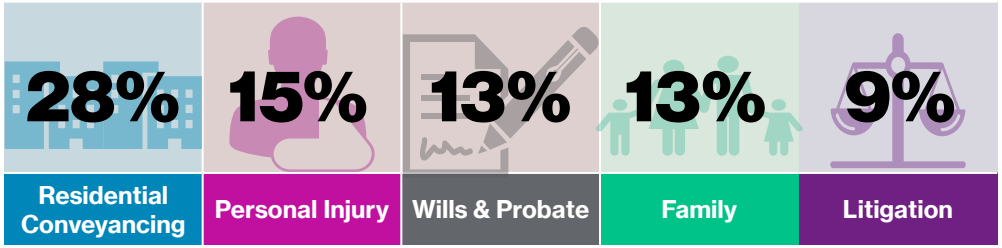


The SRA First Tier Complaints report agreed, listing its most common causes of complaint as Delay (18%), Failure to advise (13%) and excessive costs (12%). The SRA reported on in excess of over 30,000 complaints received.

Encouragingly, the SRA First Tier Complaints report states that 80% of complaints received by law firms in 2019 were successfully resolved at the first tier stage, suggesting that law firms complaint procedures are effective. This is supported by the LeO report, which found that law firms' complaints handling procedures were adequate in 75% of the cases it investigated.

Practice areas

According to LeO's data the most common practice areas attracting complaints are:-



3. Solicitors Regulation Authority. (2021). First tier complaints 2019-2020. Retrieved from the Solicitors Regulation Authority website: https://www.sra.org.uk/sra/how-we-work/reports/first-tier-complaints-2019/
4. Legal Ombudsman. (2020). Overview of annual complaints data 2019/20. Retrieved from the Legal Ombudsman website: https://www.legalombudsman.org.uk/media/vcrpshl4/200924-overview-of-complaint-summary-final.pdf

Key Complaint areas in detail

Delay

Both the SRA and LeO reports suggest that delay was the most common cause of complaint received by law firms.

The issue appears to be actual delay, but often the delay is perceived delay, which can arise as a result of poorly managing clients expectations. It is important to be realistic with clients and try to avoid promising what you may not be able to deliver, but you also need to notify clients about any potential delays which may occur due to circumstances beyond your control and/or are caused by third parties. This is common, particularly in respect of residential conveyancing transactions, personal injury cases and administering estates because of the length of time it can take to complete these transactions and number of different stages and parties involved. Clients are not always made fully aware of or understand what the process involves.

One way in which delay can be improved is through better communication. Working from home has its difficulties but finding time to provide the client with a quick update by email, or telephone, will make all the difference and can alleviate a lot of concerns, reduce the number of complaints and strengthen client relationships.

Failing to properly advise

Failing to properly advise clients was another cause of complaint received by law firms. It is important that clients are provided with the information that they need to make informed decisions about their matters in a clear and transparent way, including how it will be handled and what options are available to them. They also need to be made aware of all their different options and outcomes including any potential risks involved with their matters as well as costs information.

The LeO report states that failure to properly advise is a common cause for complaint in residential conveyancing matters. Clients are not being made fully aware of risks around the title of their property such as boundary issues and restrictive covenants. This cause for concern also arises in litigation matters. It is important that clients fully understand the court process and what is involved, and they are made aware of the risks of proceeding with court action as opposed to trying to settle their claim earlier.

It is essential when providing such advice to clients it is communicated to them clearly, concisely, and ideally in writing, to avoid any misunderstanding.

Excessive costs

It is crucial that clients are provided with the best possible information about the costs of their matter at the outset, but also as the matter progresses through to completion. Some transactions can be straight forward and agreed on a fixed fee basis such as conveyancing transactions. However, litigation and family matters for example can be more complicated, and it is appreciated that the exact costs of the matter including disbursements, experts' fees and counsels' fees may not be known at the outset. There should be no nasty surprises and clients should be updated about any increase in their costs at the earliest opportunity.

Pandemic impact

Both the SRA and LeO reports suggest that there have been improvements in service standards and the way complaints are handled over the last year, which is encouraging. It is anticipated that we have not yet seen the full impact the pandemic has had on service standards, especially during the early stages of the pandemic when all businesses had to change their working practices. We may therefore see an increase in complaints in the next report because of the governmental restrictions imposed. For example, remote working has meant not being able to meet with clients face to face, court closures and a changes in internal procedures such as reduced supervision, as well as staff shortages due to the furlough scheme or illness.

Summary

What is clear from the SRA and LeO reports is that there is always room for improvement, even during unprecedented times. It is accepted that there is no one size fits all approach to handling complaints from clients, and processes will vary from firm to firm. Operating an open complaints culture and recognising that complaints handling is an integral part of your business is a good step in the right direction.

Simply taking the time to understand the complaint received from clients, providing them with a clear and concise response using a courteous tone will help to reassure the client. Often, all it takes to resolve an issue is a genuine apology, whilst this does not mean an admission of poor service it can make the client feel understood, appreciated and that their concerns are being heard.

Does the cap fit? Liability for law firms

By Jonathan Angell

Given the double-digit premium increases experienced by many firms at the October 2020 Professional Indemnity Insurance renewal, it is very likely that risk managers and insurance buyers are considering their options for the future. The upward premium trend looks set to continue, with the impact of COVID-19, Brexit and related concerns all highlighted in our recent article[1] on the renewals season.

One option for worried firms is how best to limit liability, and how this might be undertaken whilst complying with the obligations imposed by the Solicitors Regulation Authority (SRA) and the SRA Standards and Regulations (StaRs).

In this article we look at whether limiting or capping liability is possible for law firms, how this might be achieved and what might be appropriate steps to take.

Why limit liability?

Law firms, like other professional service organisations, are offering a service at a cost. The impact of getting something wrong can be significant and so it makes sense to try and limit or cap liability in some way.

Other sectors have used liability caps more readily. It makes commercial sense to link risk with reward, and this is a concept that clients should understand and appreciate. Equally to insurers it demonstrates a sound understanding of risk, and risk management.

1. https://www.willistowerswatson.com/en-GB/Insights/2020/11/october-2020-solicitors-professional-indemnity-insurance-renewal

The SRA's approach

There are three main regulatory and legislative areas for firms to consider. The SRA Indemnity Insurance Rules ('the Rules')[2], (including the accompanying Guidance Note[3]), the Unfair Contract Terms Act 1977[4], and the Consumer Rights Act 2015[5]. In considering whether to limit liability it would be prudent to consider those areas of legislation thoroughly. In this article we discuss solely the SRA's approach to limiting liability.

The StaRs require that clients are treated fairly, and that 'you do not abuse your position by taking unfair advantage of clients or others.' This is arguably the key underlying requirement for law firms and is further embedded in the Code of Conduct for Solicitors requiring that 'you give clients information in a way that they can understand[6].'

The SRA is a consumer focused regulator, hence clarity of advice to consumers is a central plank of their approach to regulation.

In addition, the Rules require firms to:

1. 'take out and maintain professional indemnity insurance that provides adequate and appropriate cover,' and
2. not exclude or limit liability below the minimum level of cover (Rule 3.2) which is £3 million for a relevant recognised body or a relevant licensed body and £2 million for an Alternative Business Structure. Under Annex 1 of the Rules limits on liability can only be used on amounts over the minimum level of cover.

The SRA Guidance requires that any limit or cap: -

- Is fair and reasonable to the specific circumstances, further embedding the requirement under the StaRs
- Reflects the power and knowledge of the transaction or relationship
- Takes into account the best interests of the client; supporting SRA Principle 7 that solicitors 'act in the best interests of each client'[7]
- Is communicated to the client so that they can understand the impact

The SRA makes the clear statement that they

> **"would not expect to see caps put on liability to clients as a matter of course**

What is an appropriate limit?

Liability can never be excluded entirely, and we have already looked at the minimum levels the Rules the SRA require.

Equally, under the Rules the SRA require that any limitation must be fair and reasonable. To this purpose we have historically seen limits set at the Professional Indemnity Insurance limit or as a multiplier of fees. Perhaps to avoid the appearance of capping liability as 'a matter of course' any limitation should be a reasonable appraisal of the probable loss on a negligence claim.

2. https://www.sra.org.uk/solicitors/standards-regulations/indemnity-insurance-rules
3. https://www.sra.org.uk/solicitors/guidance/adequate-and-appropriate-indemnity-insurance
4. https://www.legislation.gov.uk/ukpga/1977/50/contents
5. https://www.legislation.gov.uk/ukpga/2015/15/part/1/chapter/1/enacted
6. https://www.sra.org.uk/solicitors/standards-regulations/code-conduct-solicitors/
7. https://www.sra.org.uk/solicitors/standards-regulations/principles/

How to limit liability

Firms should consider the following points when they are considering limiting liability. All points should be clearly documented:

Why are you limiting liability in this particular matter?

- The onus is on the firm to clearly lay out why this matter warrants a different approach. File notes and records of internal discussions will assist in this respect.

Power and knowledge of the transaction or relationship

- As a consumer protection focused regulator, the SRA is unlikely to favourably consider requests to cap or limit liability for consumer clients. There is likely to be more consideration given to limiting liability for commercial clients.

Make it clear and obvious to the client

- Overtly draw the client's attention to the limitation, make it explicit and outside of your standard Terms of Engagement. This will help support the requirement to communicate to the client in a way that they can understand the impact.
- You may go further and suggest to the client that they contact you to discuss, and again if they do then you must fully document that discussion and what was agreed with the client on the file.

Conclusion

This article discusses the considerations when looking at limiting liability and the steps required to comply with the SRA requirements.

We have already referred to the more frequent incidence of limiting liability across many professions which contrasts with the approach taken within legal services. Whether this is due to a sense of ambiguity over the regulator's stance is unclear.

It is possible to use liability caps and stay on the right side of the regulatory tightrope but, in order to do so, the SRA will want to see that client interests are protected and that clients are given sufficient information to make informed choices.

Money laundering continues to be a priority risk

By Joanne Cracknell

During 2020 the legal profession has experienced a year of change and turbulence, largely as a result of Brexit and the coronavirus pandemic. However, one issue that has remained constant throughout this crisis is the threat of money laundering which remains a priority risk and challenge to law firms[1].

Money laundering is not a victimless crime. Criminals depend on money laundering to profit from drugs and human trafficking, prostitution rings, illegal arms trade and preying on the vulnerable.

In the latest Risk Outlook Report published by the Solicitors Regulation Authority (SRA)[2] money laundering continues to feature as a priority risk because it is known that criminals rely on the services provided by solicitors as it adds a veneer of legitimacy to transactions. Conveyancing, managing trusts, creating companies and handling client money are the areas identified as being the most at risk. It is understood that the volume of money laundering related matters being handled by the SRA is increasing[3]. The National Crime Agency (NCA) has also reported a record number of suspicious activity reports (SARs) being submitted to and processed by the UK Financial Intelligence Unit (UKFIU) in its latest annual report[4], as set out below:-

573,085 SARs received between April 2019 and March 2020 (19.78% increase on 2018/19 478,437)

62,408 defence requests (up 80.67% on the previous year's 34,543)

3,006 SARs were made by the legal profession, an increase of 8.36% from last year

1. Solicitors Regulation Authority. (2020). Anti-money laundering. Retrieved from the Solicitors Regulation Authority website: https://www.sra.org.uk/risk/outlook/risk-outlook-2020-21/anti-money-laundering/
2. Solicitors Regulation Authority. (2020). Risk Outlook 2020/2021. Retrieved from the Solicitors Regulation Authority website: https://www.sra.org.uk/risk/outlook/risk-outlook-2020-21/
3. Hyde, J., (2020, 23 November). SRA tells firms: Check exactly where your client's money came from. Retrieved from the Law Gazette website: https://www.lawgazette.co.uk/news/sra-tells-firms-check-exactly-where-your-clients-money-came-from/5106520.article?utm_source=gazette_newsletter&utm_medium=email&utm_
4. National Crime Agency. (2020). UK Financial Intelligence Unit Suspicious Activity Reports Annual Report 2020. Retrieved from the National Crime Agency website: https://www.nationalcrimeagency.gov.uk/who-we-are/publications/480-sars-annual-report-2020/file

What this means is that suspected criminals were denied in the region of £172m[4], which disrupts criminal activity and sends criminals the message that the UK is an increasingly hostile environment for those seeking to launder proceeds of crime.

It is arguable that the increase in matters being handled by the SRA are as a result of the heightened awareness following guidance and warning notices being issued by both regulators and law enforcement during the pandemic, warning about criminals taking advantage of the coronavirus.

The increase in the SARs reporting figures are encouraging, especially as the UKFIU has been working closely with the Law Society over the last year to build trust and develop relationships, following the criticism the legal profession has received over the years from law enforcement regarding the low level of SAR submissions and/or poor quality SARs. The UKFIU has been holding quarterly meetings with the Law Society of England and Wales AML Task Force and issued guidance on how to submit better quality SARs which we commented on in November 2020[5]. Furthermore, representatives from the UKFIU presented a session at the SRA's Annual Compliance Officer Conference about what makes a good quality SAR[6].

Risk Areas

In the SRA's Risk Outlook unsurprisingly conveyancing work continues to be the practice area which is considered high risk to money laundering. During the pandemic as a result of the stamp duty land tax holiday, the volume and value of property transactions has increased, which in turn leads to a busier work load for fee earners who may be less vigilant to money laundering risks whilst they are under pressure to complete the transactions as quickly as possible.

The SRA's Risk Outlook also identifies an increase in vendor fraud, seen previously during the last recession. Fraudsters are selling properties without the genuine proprietors' consent or knowledge. Sadly, the fraudsters are often targeting elderly and vulnerable people.

Another area of concern to the regulator arises from potential overseas clients who are high net worth individuals seeking to exploit the investor visa scheme.

As always, vigilance is key and it is essential that fee earners including partners receive the appropriate training and where necessary supervision, especially if working remotely. Furthermore, it is crucial that solicitors are alive to the red flag warning signs, are satisfying client due diligence requirements, verifying the source of funds and know who to report any concerns to.

The Legal Services Affinity Group (LSAG) has highlighted some of the latest anti money laundering risks[7] which include:

- being asked to work with unusual types of clients
- being instructed on matters outside your own or the firm's usual areas of experience or expertise
- being pressured to expedite or avoid satisfying the client due diligence process
- attempting to make deposits into the client account where no legal services are provided
- transactions where the business rationale is unclear

5. Suspicious activity reports (SARS) during the coronavirus pandemic: https://www.willistowerswatson.com/en-GB/Insights/2020/11/suspicious-activity-reports-sars-during-the-coronavirus-pandemic
6. Solicitors Regulation Authority. (2020). Compliance Officers Conference. Retrieved from the Solicitors Regulation Authority website: https://www.sra.org.uk/sra/news/events/on-demand-events/colp-cofa-2019/
7. The Law Society. (2020). LSAG Advisory Note: COVID-19 and preventing money laundering and terrorist financing in legal practices. Retrieved from the Law Society website: https://www.lawsociety.org.uk/en/topics/anti-money-laundering/lsag-advisory-note-covid-19-and-preventing-money-laundering

Despite the pandemic the SRA has continued to carry out its AML visits to ensure that those law firms within scope of the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017[8] (MLR 2017) have adequate and effective policies, controls and procedures in place to prevent their firms being targeted by money launderers.

The SRA has recently published its report following the first year of visits which took place during September 2019 and October 2020[9]. Initially the visits were carried out on site but during the pandemic the reviews were conducted remotely.

74 firms were involved in the exercise from across England and Wales. Overall, the visits identified that the profession wanted to prevent money laundering and comply with the regulations but as always there is room for improvement.

The areas that required the most work were:

The Audit Process

Despite Regulation 21(1)(c) of MLR 2017 stipulating that firms need to establish an independent audit function to examine and evaluate the adequacy and efficacy of their policies, controls and procedures, there is still work needed in this area. The review suggested that there is some misunderstanding over what is required in this regard. 51% of the law firms involved in the review needed follow up action and 19% of law firms had never conducted any audit.

Screening of Employees

Regulation 21(1)(b) of MLR 2017 requires firms to undertaken screening of employees, including partners and directors. Overall law firms were generally compliant with the requirement to screen employees prior to their appointment. However, 21% of firms were failing to carry out ongoing checks.

Good practices identified during the review included law firms using a variety of methods of screening including qualifications, regulatory history, DBS checks and references, to ensure that the firm knows as much as possible about their fee earners rather than over reliance on personal knowledge of an individual.

Matter Risk Assessments

The review highlighted inadequacies around conducting matter risk assessments. On 29% of the files reviewed by the SRA no matter risk assessment had been carried out. Assessing the risk of a matter is an integral part of the file opening process. The assessment highlights whether a matter requires enhanced due diligence and on going monitoring, and that the file needs to be reviewed at certain stages of the transaction, such as before exchange and completion on a conveyancing matter, or prior to distributing monies when administering an estate on a probate matter.

Some good practices identified during the SRA review included firms placing blocks on their internal systems that restricted fee earners from progressing the transaction or billing the matter until the risk assessment process had been completed.

Source of Funds

Regulation 28(11) of MLR 2017 provides that firms are required to verify the source of funds to ensure that the transactions are consistent with the fee earner's knowledge of their client, business and risk profile. The key here is that solicitors need to understand how the client obtained the money for that specific transaction.

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8. https://www.legislation.gov.uk/uksi/2017/692/made

9. Solicitors Regulation Authority. (2020). Anti-Money Laundering (AML) Visits 2019-2020. November 2020. Retrieved from the Solicitors Regulation Authority website: https://www.sra.org.uk/globalassets/documents/sra/research/anti-money-laundering-aml-visits-2019-2020.pdf?version=4ada2c

In addition to Regulation 28(11), if a firm acts for a politically exposed person then Regulation 35 stipulates that firms must take adequate measures to establish both the source of wealth and funds involved in the business relationship or transaction with that client.

The SRA deem it best practice to obtain evidence of the client's source of funds during the early stages of the transaction, ideally as part of satisfying the client due diligence process. It is an essential part of the matter risk assessment. Clients should be informed about what the process involves and what documents are needed at the outset of the retainer. Obtaining as much documentary evidence as possible about the client's source of funds and assessing these documents will assist with evidencing compliance with the regulations, and in turn will help with preventing money laundering.

However, the review highlighted that 21% of the files examined failed to evidence that the client's source of funds had been verified properly, if at all. Failing to verify a client's source of funds is likely to suggest a failure to fully understand the possible risks involved in the transaction and firms may leave themselves open to the risk of facilitating money laundering. The LSAG will be issuing updated guidance setting out what is expected in respect of verifying a client's source of funds shortly.

Remedial and Enforcement Action

The SRA expect firms to comply with the money laundering regulations and will work with firms offering assistance and guidance where needed, or enter into a compliance plan to rectify any short comings. During the visits 64% of the firms reviewed needed some form of remedial action which included updating their AML policies and procedures and reviewing live files to ensure client due diligence procedures were being satisfied. 12 of those firms received written guidance and nine firms were referred to the AML Investigation Team for further investigation due to more serious breaches being discovered.

For those individuals and/or firms failing to comply with the money laundering regulations, the SRA will take robust enforcement action and refer the most serious incidents to the Solicitors Disciplinary Tribunal. A recent example of this resulted in a partner specialising in immigration work being suspended indefinitely for failing to verify the identity of the client and the source of their funds and as well as allowing the firm's client account to be used as a banking facility[10]. The solicitor had been approached by overseas individuals to act on an $80m international transaction. They were offered $300,000 to accept the monies from overseas into their client account and subsequently pay the monies to third parties.

This case study highlights the importance of:-

- verifying a client's identification
- understanding where the monies for the transaction comes from
- not taking on matters which fall outside of your own or the firm's usual areas of experience or expertise or involving limited legal advice
- not allowing the client account to be used as a banking facility

All of the points above were concerns previously raised as risks by the LSAG and the SRA and it is therefore crucial that law firms remain vigilant and satisfy their regulatory and legislative obligations to combat the threat to the legal profession from money laundering. We do not know how the pandemic will play out but what is certain is that criminals will continue to take advantage of these challenging times. Having robust policies, controls and procedures in place will minimise the risk of solicitors facilitating money laundering which not only impacts the UK economy but damages the reputation of the legal profession. Doing so will also help to reinforce the message that the UK is a hostile environment for criminals to conduct their business.

10. Solicitors Regulation Authority. (2020). Anti-money laundering. Retrieved from the Solicitors Regulation Authority website: https://www.sra.org.uk/risk/outlook/risk-outlook-2020-21/anti-money-laundering/

National Risk Assessment 2020

By Joanne Cracknell

Assessing the UK's risk to money laundering

As one of the most tumultuous years came to a close, the UK government published its Third National Risk Assessment (NRA 2020)[1], which comprehensively assesses the UK's key money laundering and terrorist financing risks. The NRA analyses money laundering and terrorist financing risks facing all sectors, services and entities by examining documentary evidence submitted by law enforcement agencies, government departments, regulatory supervisors, private sector organisations and published data, which also includes information submitted by the regulators of the legal profession. This article will summarise the findings of the risks facing the legal sector.

1. HM Treasury and Home Office. (2020). National risk assessment of money laundering and terrorist financing 2020. Retrieved from the UK Government website: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/945411/NRA_2020_v1.2_FOR_PUBLICATION.pdf

Background

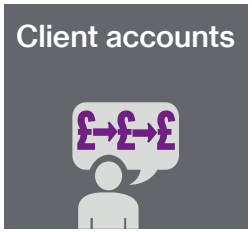
Since the last National Risk Assessment (NRA) in 2017 the UK has been the subject of a very successful mutual evaluation by the Financial Action Task Force (FATF). In December 2018 FATF assessed the UK as having a robust understanding of money laundering and terrorist financing risks[2] despite the scale of money laundering impacting the UK being £100billion plus each year[3]. The purpose of the mutual evaluation is to assess the UK's level of compliance with the FATF 40 Recommendations[4] and the efficacy of the country's anti money laundering and counter terrorist financing regime.

Whilst the UK received the best rating out of 100 countries evaluated during 2018 there can be no room for complacency. The scale of the threat of serious and organised crime to the UK economy is becoming more complex, as criminals adapt their methodologies, seek to exploit advances in technology and take advantage of the coronavirus pandemic (COVID-19). The UK has implemented measures to increase resilience in order to protect the economy and safeguarding the country's recovery following the pandemic.

Summary of the findings

The legal profession continues to be at a **high** risk of being used in money laundering as criminals seek to abuse legal services provided. However, the NRA 2020 identified that legal services are not attractive to terrorist financing and therefore the profession still remains at a **low** risk in that respect.

The services that are considered to be most at risk of exploitation by criminals to money laundering are:-



The NRA 2020 states there still remains a risk that

"some legal professionals are complicit and willingly enable money laundering"

and therefore it is essential that solicitors comply with their regulatory and money laundering regulation obligations, and apply a risk based approach rather than "a tick box approach" to compliance.

2. Financial Action Task Force. (2018). Anti-money laundering and counter-terrorist financing measures United Kingdom Mutual Evaluation Report December 2018. Retrieved from the Financial Action Task Force website: https://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-Kingdom-2018.pdf
3. National Crime Agency. (2020). Money laundering and illicit finance. Retrieved from the National Crime Agency website: https://www.nationalcrimeagency.gov.uk/what-we-do/crime-threats/money-laundering-and-illicit-finance
4. Financial Action Task Force. (2020). FATF recommendations. Retrieved from the Financial Action Task Force website: http://www.fatf-gafi.org/publications/fatfrecommendations/?hf=10&b=0&s=desc(fatf_releasedate)

High Risk Practice Areas

Looking at each of the high risk practice areas identified in the NRA 2020 in turn:-

Conveyancing

The risks arising from this practice area have not changed since the first NRA was published in 2015. The UK property market is attractive to criminals operating both home and abroad as this offers them the perfect opportunity to conceal their illicit proceeds and disguise their true ownership and origins. Residential conveyancing and commercial property transactions are highly vulnerable to the threat of money laundering owing to the high volumes of transactions and high values involved. The latest assessment suggests that criminals are still favouring London to invest their money in property, but they are increasingly targeting university towns, due to the high demand for rental property from students which is resulting in high returns for buy to let investors.

The Solicitors Regulation Authority (SRA) also recognise conveyancing as a priority risk to the legal sector and it continues to assess how law firms comply with the money laundering regulations[5]. The NRA 2020 further evidenced the importance of conducting risk assessments, verifying the identity of clients and their source of funds. Solicitors conducting conveyancing work must be alive to the red flag indicators and the NRA 2020 has highlighted the following as some examples of red flags (indicating a higher risk of money laundering):

- clients seeking anonymity and purchasing property through complex corporate structures, such as companies based in secrecy jurisdictions which can conceal the identity of the ultimate beneficial owner
- clients purchasing property using cash with no verifiable source of income justifying their wealth
- conveyancing transactions that involve multiple legal service providers
- clients who are politically exposed persons from high corruption/high risk jurisdictions and those charged with or alleged to have committed corruption offences

Provision of trusts and company services

Creating and managing trusts and company structures continues to be a service where solicitors can find themselves negligently, unwittingly or complicitly facilitating money laundering. As we saw from the Panama and Paradise Papers data leaks and the Danske Bank scandal, complex corporate structures are used by criminals to move their illicit proceeds around the world, concealing both the true origins of those monies and the true ownership of the companies involved. It is estimated that millions of pounds are being laundered through legal entities in the UK.

The risk score has increased in this work type from **medium** in the 2017 NRA to **high** in 2020. It Is estimated that 23% of businesses providing trust and company services are law firms. The NRA 2020 has assessed that the risks associated with this area of work are heightened by poor compliance. The SRA conducted a thematic review on trust and company service providers in 2018, and the Law Society of Scotland conducted a similar review in 2020; both reviews identified that a significant number of the firms reviewed were failing to satisfy their money laundering regulation obligations.

The concern is that in the UK legal entities can be created cheaply and quickly and can be set-up directly with Companies House rather than through a trust and companies service provider, therefore circumventing the verification process. However, efforts are being made through Limited Partnership Reform and Corporate Transparency and Register Reform programmes to increase the transparency of companies and other legal entities.

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5. Solicitors Regulation Authority. (2020). Anti-money laundering. Retrieved from the Solicitors Regulation Authority's website: https://www.sra.org.uk/risk/outlook/risk-outlook-2020-21/anti-money-laundering/

The SRA issued guidance on the provision of trust and company services in November 2020[6] which provides a number of examples of red flag indicators that may arise in this type of work such as:-

- Transactions where the client wants or appears to seek to use entities that involve multiple countries that are unconnected with the client or the transaction without any legitimate reason
- Creating or using an entity type that is noted to provide greater opacity or secrecy with no legitimate reason, e.g. Scottish Limited Partnerships
- Taking any action that may disguise the actual controlling party of an entity, such as using family relationships to add a layer of separation between the actual controller of assets, and either the trustee(s) or beneficiaries of a trust

Misuse and exploitation of client accounts

The misuse and exploitation of law firms' client accounts continues to be high risk to the threat from money laundering. The NRA 2020 has assessed that client accounts remain attractive to criminals to enable their proceeds of crime to be transferred to third parties. Criminals are increasingly becoming more sophisticated in their methodologies and there has been a rise in cases involving sham litigation and fraudulent investment schemes.

The NRA 2020 provides an example of such cases where law firms have been approached by potential new clients based overseas asking the firms to represent their company in a dispute with a UK based business. In some circumstances the law firms have carried out the necessary on boarding procedures and subsequently provided the potential new clients with their terms of engagement. The new client accepts the law firm's terms and subsequently transfers a significant sum of money to the law firm as payment on account. However, a few days later the client informs the law firm that the dispute has been resolved and requests the monies be returned less the fee for time spent, consequently 'cleaning' the money.

Whilst solicitors must safeguard any money or assets entrusted in them by clients and others in accordance with paragraph 4.2 of the Code of Conduct for Solicitors[7] and Part 2 of the SRA Accounts Rules[8] (which deals specifically with client money and client accounts), law firms must not allow their client accounts to be used as banking facilities.

Permitting their client accounts to be misused and exploited can have serious consequences and may result in the solicitor involved being subject to disciplinary proceedings and in the worst case scenario struck off and/or imprisoned but such actions also damages the reputation of the law firm and the legal profession as a whole.

Summary

It is reassuring to know that since the very first NRA in 2015[9] which highly criticised the legal profession stating that there were "complicit legal professionals facilitating money laundering", the profession is fairing more favourably in the risk assessment. The NRA 2020 has identified that overall the legal profession complies with their anti-money laundering obligations but as always there is still more work to be done. It is understood that the regulators of the legal profession are discovering during their respective reviews that some members of the legal sector still lack an understanding of the risks the profession faces from money laundering. In addition, the policies, controls and procedures implemented by law firms to prevent money laundering continue to be lacking or inadequate, and suggests further work is required to build a strong anti money laundering culture.

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6. Solicitors Regulation Authority. (2020). Trust and Company Service Provider guidance. Retrieved from the Solicitors Regulation Authority's website: https://www.sra.org.uk/solicitors/resources/money-laundering/money-laundering/trust-company-service-provider-guidance/
7. Solicitors Regulation Authority. (2020). SRA Code of Conduct for Solicitors, RELs and RFLs. Retrieved from the Solicitors Regulation Authority website: https://www.sra.org.uk/solicitors/standards-regulations/code-conduct-solicitors/
8. Solicitors Regulation Authority. (2020). SRA Accounts Rules. Retrieved from the Solicitors Regulation Authority website: https://www.sra.org.uk/solicitors/standards-regulations/accounts-rules/
9. HM Treasury and Home Office. (2020). UK national risk assessment of money laundering and terrorist financing. Retrieved from the UK Government website: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/468210/UK_NRA_October_2015_final_web.pdf

Silent cyber – breaking the silence

By Joanne Cracknell

As the risk of cyber-attacks and the fallout from such events continues to hit the headlines, we look at the recent changes to professional indemnity insurance and how this impacts law firms.

What is silent cyber?

Silent or non-affirmative cover relates to a scenario where a policy might pick up losses that were not explicitly detailed in the policy wording. In effect ambiguity over the language used in a policy that can lead to uncertainty over what is, or is not, covered.

Cyber cover is a relatively new class of business. As business operations have moved on-line risks of cyber incidents or attacks has increased. Recently we have seen attacks or incidents involving major travel companies, football clubs and local councils. The fallout from a cyber-attack is a complicated one with implications for data protection and the physical impact on premises amongst the myriad of concerns.

Background

In recent years the insurance industry has become increasingly concerned about the issue of silent cyber. In the UK both the Prudential Regulatory Authority[1] (PRA) and Lloyds of London[2] (Lloyds) have been keen to ensure that clarity is brought to the market, and policies are clear on whether losses caused by a cyber event are covered. This led to a rolling programme for different insurance products to explicitly include or exclude cover related to losses caused by cyber events.

Lloyds' cyber affirmation / exclusion rollout started in January 2020. Professional Indemnity Insurance (PII) is part of the programme with effect from 1 January 2021; any PII policy that incepts or renews on or after 1 January 2021, will need to contain an explicit clause in respect of cyber.

Why is this an issue?

The issue centres on whether an incident and the accompanying actions to resolve that incident are covered by a firm's PII policy. Broadly a cyber incident has three strands: -

1. **Cyber-attack:** The introduction of ransomware or malware into a firm's IT infrastructure.
2. **Cyber incident:** An accidental event, this might include an IT system failing and the cost of it not being accessible.
3. **Data privacy:** The data that is held electronically being compromised and the accompanying actions to report and resolve any data breach.

Any of these scenarios could cause significant impact and costs to businesses, clients and third parties. This may include regulatory investigations, costs of specialist IT support, business interruption and legal costs. The extent to which those losses are covered, and whether a cyber policy or another policy reacts, or indeed any other policy reacts, is the crux of this issue.

Insurers have been increasingly concerned about covering losses on PII policies that they did not appreciate they were exposed to, and accordingly had not priced for. Equally policyholders have been affected when they discovered that their PII policy would not react to cover such circumstances.

Clarity in this area is needed; hence the review by Lloyds and the actions of the PRA, and this clarity will surely benefit all parties. Policyholders should know what specific policies cover and this will enable them to make appropriate decisions.

1. https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/letter/2019/cyber-underwriting-risk-follow-up-survey-results
2. https://cortexonelolbeta.azureedge.net/assets/y5277-update-providing-clarity-for-lloyds-customers-on-coverage-for-cyber-exposures/1/Y5277%20Update%20%20Providing%20clarity%20for%20Lloyds%20customers%20on%20coverage%20for%20cyber%20exposures.pdf

PII and Silent Cyber

The variety of possible claims, and the almost total dependency on IT systems in one form or another for business, makes it very difficult to ascertain whether a claim is cyber related or not. This is the clarity that the PRA and Lloyds are looking to provide to insurers and policyholders.

The difficulty though lies in distinguishing whether the claim should rest with the cyber policy or with the PII policy. If a firm is negligent in their cyber security procedures is this a PII claim or a cyber claim?

For example, a client inadvertently pays monies to a fraudster after receiving an email supposedly from their law firm stating that the law firm's bank details have changed. The law firm may not have directly caused the loss, but have they contributed to it by not previously advising clients of the tactics and techniques used by fraudsters to steal money in this way.

Equally the law firm could be alleged to be negligent if they have poor controls in place around how they provide their bank details or have failed to follow industry best practice in this area.

In this scenario the law firm may have owed the client a duty of care to provide bank details in a secure manner due to the high risk and impact of fraud. The firm may have breached that duty by not following their own policies and procedures or industry guidance on providing banking details to the client; it is arguable the law firm did not cause the loss suffered by the client but they may have contributed to it.

Another example may arise from phishing attacks which originate by email and so obviously seem cyber related. But are the actions of the person who opens the email negligent or is the firm itself negligent as it is arguable that it has not trained its employees appropriately; or its policies and procedures are not in themselves robust enough and are not being followed. The loss of client data could lead to significant claims and not to forget possible disciplinary proceedings/penalties imposed by the Information Commissioner's Office and the Solicitors Regulation Authority.

Conclusion

In preparation for the 1 January 2021 implementation date the International Underwriting Association's Professional Indemnity Forum (PIF) created a working group to consider the overlap and gaps between traditional PII policies and standalone cyber insurance products[3]. That document includes several examples, but the underlying theme is that there is rarely consensus on whether or by which policy those examples are covered.

Clearly it is vital that policyholders know whether they are covered, and what they are covered for in respect of any insurance policy. It may be that your existing PII policy no longer covers you for a cyber related accident or incident, and you now need a stand-alone cyber policy.

If you have not already started conversations with your broker on these points, then you should do so as soon as possible. Consideration needs to be given to the full spectrum of your cover, considering all the policies and how these would react in the event of a cyber related incident.

If we can be of further assistance, please do not hesitate to contact us.

3. https://www.iua.co.uk/IUA_Member/Clauses/eLibrary/Clauses_Summary.aspx?DocumentKey=35F13310-2FC0-4159-8491-76BA17FEF0CF

Disclaimer

Each applicable policy of insurance must be reviewed to determine the extent, if any, of coverage for COVID-19. Coverage may vary depending on the jurisdiction and circumstances. For global client programs it is critical to consider all local operations and how policies may or may not include COVID-19 coverage.

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