

# Compliance for Law Firms

MATTHEW MOORE



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## Executive summary

LAW FIRM compliance is headline news again. Less than two years after the creation of the Solicitors Regulation Authority (SRA), a major review of how the profession is regulated has just been announced. The review – to be headed by Lord Hunt of Wirral, formerly senior partner of Beachcroft – will examine what “effective modern regulation means in the context of the legal profession” (*Gazette*, 16 October 2008). Lord Hunt has announced that he has a “completely open mind” on the likely outcome and has stressed the independent nature of the exercise (*Gazette*, 23 October 2008).

So what will be the main issues and concerns that will need to be addressed? An obvious starting point will be who the regulators should be. There have been increasing tensions between the Law Society and the SRA, with major commercial firms becoming increasingly vociferous in their criticism of how the SRA have addressed their sector of the profession. How, they ask, can the greater scrutiny that they have been subjected to in recent months be justified on an approach to regulation that is professed to be risk-based? The possibility of large commercial firms breaking away from SRA control has been openly discussed and is the option favoured by some. Others see redemption for the SRA if it can develop a style of regulation that is more in tune with major commercial practice.

Another fundamental issue will be the regulations that apply. The Solicitors’ Code of Conduct finally took effect in mid-2007

and is generally seen as an improvement on the Guide to the Professional Conduct of Solicitors that it replaced, but the suitability of the ‘one size fits all’ rulebook for an increasingly diverse profession is also questioned. There are increasing calls for a new code for commercial practice, or at least a substantial revision of how the Code is interpreted in major firms. As David McIntosh, Chair of the City of London Law Society, commented in the *Law Society Gazette* of 30 October 2008: “corporate purchasers of legal services do not need the same regulatory protections as my mother when she occasionally instructs a local solicitor”.

This report examines all these trends and more. It examines the obligations for firms in areas such as supervision and the associated management ‘arrangements’ required by Rule 5 of the Code of Conduct and suggests how rules primarily intended for high-street practice need to be interpreted by larger firms. Other key provisions in the Code are covered, including those dealing with client relations, conflicts of interests and diversity. There is also expert comment on the growing issue of IT security and the obligations of law firms arising from the data-protection principles and associated provisions.

Finally, this report considers the usefulness of externally-assessed formal quality and risk programmes such as Lexcel and ISO 9001. A new risk management standard – BS 31100 – has also just been unveiled. The take-up of formal standards amongst larger firms has been proportionally

greater than the rest of the profession, with 20 per cent of the top 100 firms having one or other of these standards in place. What led these firms to take this step and do they consider their efforts to have been worthwhile? Are the benefits limited to improving their tendering profile or do they facilitate genuine changes to internal structures? The report also introduces the Commercial Risk and Quality Standard – a programme which sets out the essential risk and management standards needed for major firms.

This report will be essential reading for the many firms that are reviewing their internal regulatory control systems. It has been compiled by Matthew Moore, a leading authority on law firm quality-management programmes and for many years the principal trainer for the Law Society in the Lexcel scheme. Contributors and case-study profiles include:

- Martineau;
- LG;
- David McIntosh;
- Pinsent Masons;
- TLT Solicitors; and
- Simon Young.

The text is accompanied by a comparison chart showing equivalent provisions of the former Guide to the Professional Conduct of Solicitors and the Solicitors' Code of Conduct 2007.

# Acknowledgements

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## About the author

MATTHEW MOORE is a law teacher and solicitor by background. He joined the then M5 group (later NRM5) as its first employee in 1985 and oversaw the period of the group's most rapid growth with responsibilities that included training, recruitment and marketing. Since leaving the group in 1989 he has operated as a management consultant and trainer for a wide variety of firms and legal organisations, at various stages also holding the posts of head of management training at Central Law Training and quality manager at Pannone. Internationally he advised the Singapore Law Society on the development of its quality standard in 2005 and the Law Society of New South Wales on its first adaptation of ISO 9001 to legal practice in 1993.

His particular specialisms are risk, quality and professional compliance issues, including the planning of and training in anti-money laundering programmes. He was for many years the principal trainer for the Law Society in its Lexcel scheme and is the main author of the Commercial Risk and Quality Standard, a programme which converts generic standards such as ISO 9001 and BS 31100 to commercial legal practice.

Matthew is a director of Web4Law and is also a member of the Chartered Institute of Personnel and Development. His other publications include the *Lexcel Office Procedures Manual* which is now in its fourth edition, and he is the co-author of *Money Laundering Compliance for Law Firms* which is also published by Ark Group. He can be contacted at [matt@web4law.biz](mailto:matt@web4law.biz).

# Introduction

COMPLIANCE IS an area of increasing concern for most law firms, and for the individuals who manage them in particular. It is not just the volume of compliance issues that appears to be on the increase, it is also that the severity of the attendant penalties in the event of any transgression. In some instances the sanctions go beyond the normal professional framework and are to be found in the criminal law – anti-money laundering provisions providing the most obvious example. There is even the risk of actions that are taken here leading to extradition requests from overseas and, as the ‘NatWest three’ bankers found, conviction in the United States of America for conduct that was not deemed worthy of prosecution in the UK. Few seem to anticipate that this upward trend in compliance obligations will be reversed. On the contrary, the implementation of the Legal Services Act 2007, now gathering pace, is set to add significantly to every law firm’s regulatory compliance burden. Little wonder that so many major firms have expressed concerns over this growing trend in recent times and continue to announce new high-profile appointments of risk partners and directors.

Compliance is also a topical issue in other ways. The latter months of 2008 have seen changes to the banking and financial sector that would have been unimaginable just a few months before. We have witnessed the collapse of various merchant banking names and most of the high street banking

giants have had to seek part-nationalisation to overcome their liquidity problems. Just as remarkably, an Icelandic bank where many millions of pounds of UK public money were invested has been made the subject of a freezing order under anti-terrorism legislation. Within the legal profession, general practitioners have seen the volume of conveyancing transactions slow to a trickle and several hundred firms were unable to renew their indemnity insurance in October, with many of them accordingly having to close. Helpline services such as the Solicitors Assistance Scheme have reported dramatic increases in calls about practice failures, which have had disastrous consequences in many instances. Nor have the problems been confined to the high street – an article in the November 2008 issue of *Legal Business* announced that 30 per cent of the top 100 law firms had made redundancies since the onset of the credit crunch in the summer. The same issue reports on a predictable increase in negligence claims as the economy enters a recession and parties look to recover their losses. Mistakes were always more likely in the good times and firms now find themselves having to stave off claims at a time when they are also “struggling to comply with an explosion of regulatory and compliance obligations”<sup>1</sup>.

Aside from market conditions, many of the reasons for this increased emphasis on compliance issues can be traced back to the split within the former Law Society between its regulatory and representative

functions in 2007. Hiving off the regulatory activities led to the creation of the Solicitors Regulation Authority (SRA) with the then Consumer Complaints Service (formerly the Office for the Supervision of Solicitors) becoming the Legal Complaints Service (LCS). The combination of regulation and representation for the profession within one organisation had long been criticised by consumer groups and politicians alike. The twin roles of trade union and professional regulators also caused confusion for solicitors caught up in disciplinary processes, with the same body at once prosecuting them and providing defensive support. The complaints process suffered similar perception problems. An unsuccessful complaint by a member of the public to the complaints body would almost inevitably lead to the retort that the Law Society's personnel had merely served to 'protect their own'. The continuation of a dual role seemed to find favour with nobody, and its demise when effected was therefore met with little opposition.

The split of functions is, however, an internal arrangement only. For the time being the Solicitors Act 1974, as amended, remains in force and this establishes the Law Society as the statutory regulator of the profession. Thus it is the Law Society that is named as the supervisory body under the Money Laundering Regulations 2007 (MLR 2007) and not the SRA. Even under the Legal Services Act 2007 it is the Law Society that will remain the regulator for the profession, though the LCS will eventually become part of a new and independently controlled 'Office for Legal Complaints'. It is against this backdrop that the Law Society has now initiated a major review of solicitor regulation to be headed by Lord Hunt of Wirral. There has been increasing tension within the profession between the regulator and the regulated, with major firms and the City of

London Law Society being amongst the most vociferous of the SRA's critics. There is now open talk of whether the SRA as currently constituted is likely ever to be a fit and proper regulator for top firms, and whether a Code of Conduct seemingly written with general practice in mind forms an appropriate basis for enforcing professional standards in the sector. Little seems as clear as it did just a few months ago and the future shape of regulation is now very much more uncertain.

For the present, however, the compliance agenda for most firms is dominated by the need to ensure that the key provisions of the Code of Conduct (the Code) and other aspects of professional regulation have been addressed, along with all related enactments such as the Money Laundering Regulations and a seemingly endless series of edicts dealing with health and safety and the use of information technology in the modern working environment. Compliance programmes are therefore seen, for the most part, as a means for organisations to control a growing list of negatives rather than to improve the firm's standing and performance. The current issue of who enforces which rules against firms features highly in such considerations.

There is, however, a different and more strategic view of compliance. Alan Hodgart preaches a simple message for firms wishing to improve their profitability and performance:

- Discipline;
- Behaviour; and
- Gearing.

This simple formula provides an easy diagnostic tool for firms that are examining their performance. It is based on Hodgart's long experience of firms of all levels of success. The firm that is dissatisfied with its

current performance will almost certainly be able to point to problems in one or more of the elements that form this trilogy.

First, and in reverse order, gearing. All work needs to be performed at its appropriate level. Either a firm must undertake top-level work that supports consistently premium rates, meaning that the owners can derive appropriate income for their efforts, or work will need to be delegated by the owners to employees who will be paid less than the proprietors. The greater the gearing, the greater the profit potential, as both the top-performing transactional firms and a number of small volume-based litigation practices will attest. Succession is, of course, a complicating factor in the issue of resources. The expert firm that is staffed only by partners may face the longer-term prospect of having to close down its operation rather than pass it on to others who will replenish the capital base. This may well remain the case even after the full implementation of the Legal Services Act and the opening up of a commercial market for practices, since the value of such a firm will always be its people rather than its processes or products. This is, however, a problem that firms of this type might accept and plan for.

The second element is partner behaviour – a key element of every firm’s culture that is often easily described but, on the ‘herding cats’ principle, notoriously difficult to change. Barristers’ chambers often refer to the issue of ‘corporatism’ – the degree to which individual members are willing to toe the collective line of their set. This is a more obvious issue in organisations that consist of a number of self-employed individuals who collaborate more to share expenses than income, but the same principle can be found in operation in solicitors’ firms. Good partner behaviour includes an acceptance

of the principle of ‘cabinet responsibility’. Doubting the partnership line with members of staff undermines those in key positions and is usually seen as unprofessional by the employees concerned. Top quality personnel want to work for cohesive practices where individuals are known to voice their disagreements in private but support the management within the firm and present a united front to the public.

Once this principle is accepted, a mixture of persuasion, influence, peer pressure and, if available, partnership sanctions should be brought to bear to ensure that partners do not involve themselves in petty politics at their partners’ and senior colleagues’ expense. Lawyers are generally clever people who have a natural tendency to question decisions and explore how they can comply with rules to the letter but not in substance. Such attitudes can be observed to be well in check in the better performing firms.

This report, however, is about the final element – discipline. Good intentions to improve working practices tend not to convert to consistency of performance unless there is a clear and specific regime in place. Compliance programmes, first and foremost, underpin the practice’s commitment that everyone in the firm should do things properly and are intended to define what is ‘best practice’ within the firm. With a formal programme in place, non-compliance becomes a more tangible issue and it will be easier to address transgressions. Insisting that everyone in the practice goes about their tasks within an agreed framework should make improvements to client service more likely. Improved client service, in turn, should result in enhanced financial performance. As an incidental benefit, senior management will have greater confidence that they have discharged their key

regulatory obligations. This report therefore argues that formal compliance programmes are increasingly important to law firms of all types and sizes, not only to address the compliance burden but also to ensure the overall business success of the practice.

A further strand to this report is that one in five of the top 100 firms have chosen to have their compliance programmes externally assessed to standards such as ISO 9001 or the Law Society's Lexcel scheme. A new risk management standard – BS 31100 – has also recently been unveiled. Should more law firms seek external accreditation of their operations and, if so, should they choose a generic business standard or the Law Society's Lexcel scheme? We examine what firms have gained from this process and whether others should follow them.

Compliance is not, of course, an isolated topic of law firm management. Most of the contents of this report could just as easily be termed 'risk management' and many parts will also have a heavy client service element to them. Increasingly there is an orthodoxy of good law firm management, and which particular heading is applied depends on the particular outlook or responsibilities of those concerned. This report therefore draws in part on my earlier collaboration with John Verry that resulted in our 2005 title *Risk and Quality Management in Legal Practice* and I am delighted that John was able to be one of the many contributors to this report. Many of the case-study profiles and interviews appeared first in Web4Law's magazine *Managing Risk*, edited by Rupert Kendrick. Particular acknowledgement is due to Duncan Finlyson, not just for his contributions but also for checking the text. Neville Miles of Lockton kindly allowed research to be conducted on returns from the 2007 PI renewal season. Thanks are also due to all of the contributors and

interviewees, some of whom chose to remain anonymous. Brief profiles of some of the contributors can be found in Appendix 2. Finally, I would like to thank the editorial team at Ark Group.

I hope that this report will be useful in developing your understanding of, and planning for, this highly topical issue.

Matthew Moore  
matt@web4law.biz  
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1. *Legal Business*, November 2008