International Risk and Compliance for Law Firms

ALISON HOOK
Executive summary ....................................................................................................................... V
About the author .......................................................................................................................... VII
Acknowledgements ...................................................................................................................... IX

Part One: The big picture – Why law firms need to think about risk internationally

Chapter 1: Introduction .............................................................................................................. 3
  What is risk? ............................................................................................................................. 3
  The legal sector and risk ......................................................................................................... 3
  The realpolitik of risk management ....................................................................................... 4
  The objective of this report ..................................................................................................... 5

Chapter 2: Why adopt an international risk management framework? .................................... 7
  The definition of international practice ................................................................................. 7
  Drivers for a risk management approach for law firms ......................................................... 8

Chapter 3: Models and principles of risk management ............................................................. 11
  International standard for risk management (ISO 31000) ..................................................... 11
  The UN Security Risk Management model .......................................................................... 11
  The ALARP model ............................................................................................................... 14
  Capital asset pricing model ..................................................................................................... 16
  The Solicitors Regulation Authority risk framework ............................................................ 17
  The lessons from risk management models ......................................................................... 18

Part Two: Identifying and analysing international risk

Introduction .................................................................................................................................. 23

Chapter 4: External threats – What to look for internationally ................................................. 25
  Political risk ............................................................................................................................. 25
  Economic risk .......................................................................................................................... 29
  Social risk ............................................................................................................................... 35
  Technology risk ....................................................................................................................... 41
  Disclosure of electronic information and data protection ...................................................... 45
Legal, regulatory, and compliance risks ................................................................. 47
Environmental threats ............................................................................................ 59
Conclusion.............................................................................................................. 60

Chapter 5: Internally driven threats – The international dimension and what you control ............................................................................................................ 63
Internal risks – Introduction ................................................................................ 63
Delivery of legal services ..................................................................................... 63
Relationship management and reputation: The risks of who you work with ........ 71
The input side of the equation .............................................................................. 76

Part Three: Managing international risk

Chapter 6: From threat register to risk management ............................................. 89
Determining impact rankings ............................................................................. 89
Classifying threat levels ..................................................................................... 91
Determining the likelihood of a threat occurring .............................................. 93

Chapter 7: Managing risk ...................................................................................... 99
Deciding which risks to manage ........................................................................ 99
Assessing and treating specific risks ............................................................... 100
Common themes in risk treatment .................................................................. 107

Chapter 8: Bringing it all together ...................................................................... 109
Governance .......................................................................................................... 109
Design of the risk management framework ..................................................... 110
Implementation ................................................................................................... 110
Monitoring and improvement of the framework .............................................. 111

Chapter 9: A final word ....................................................................................... 113

Appendix: A toolkit for international risk management ...................................... 115
A summary of the risk management process .................................................... 115
The SRA’s regulatory risk index adapted for international practice ............... 115
Country risk indicator tool .............................................................................. 119
Risk management resources ......................................................................... 124
Executive summary

‘All courses of action are risky, so prudence is not in avoiding danger (it’s impossible), but calculating risk and acting decisively.’
Niccolò Machiavelli, The Prince

RISK IS inherent in any business activity – if there were no risk there would be no reward. This is a fact of life with which some individuals, societies, and industries are naturally more comfortable than others. For example, in financial services, risk – at least calculated and understood risk – can be a positive thing, and riskier portfolios tend to yield greater rewards. In the oil and gas or construction industries, by contrast, many risks – such as selecting a drilling site or managing safety standards – cannot necessarily be broken down into palatable chunks. The goal then is to minimise these risks at the lowest reasonable and practicable cost. Unlike in these and many other industries, risk management has not traditionally had a role to play in law firms, but this has changed.

The drivers for the growing attention being paid to risk management in law firms have been both internal and external. The biggest internal driver has probably been growth in law firm size, which brings with it new challenges in terms of structuring, personnel, conflict management, and financial management. Growth can take one of two forms: organic growth or merger. Most law firms have chosen the latter route as it delivers results faster, if successful. But it can be high risk and these risks get even higher when that merger is cross border. Externally, changes in regulation and regulatory approach have also played their part in increasing the attention paid to risk management. The winding up of the Solicitors Indemnity Fund (SIF) in England and Wales required firms to go to the market for their indemnity insurance and in turn invited others, in the form of insurers, to assess at least some aspects of law firm risk and consequently the individual risk profile of any firm became relevant. More recently, the Solicitors Regulation Authority (SRA) has begun using risk management proactively, requiring SRA regulated law firms to take an active approach to risk management themselves. And the SRA is not alone. The Hong Kong Law Society has introduced mandatory courses in risk management for all Hong Kong solicitors, the Legal Services Commissioner of New South Wales requires incorporated legal practices (ILPs) to make self-assessments which include risk management aspects, and other regulators in other jurisdictions are looking attentively at these approaches.

On top of these sector-driven risk management requirements, the introduction of anti-money laundering (AML) and anti-bribery legislation in many countries has given lawyers gatekeeping responsibilities and worrying penalties for compliance failures. It is not only governments that are expecting law firms to manage their risks for them; clients increasingly not only require evidence of risk management in areas
such as information security and business continuity planning from law firms they instruct, but also look to law firms for help in managing their own risks. The positive side of this coin is that, if handled well, risk management need not only be an internal compliance cost but could even become a source of value added services to clients.

Today, the biggest individual risk management drivers for many UK law firms arise from the challenge to traditional business models in many parts of the legal economy and the quest for international work (which is widely seen as the most likely source for long term growth for commercial law firms). This report is therefore designed to address the risk management issues facing law firms operating in more than one jurisdiction, either through their own offices abroad or through cross-border working, whether alone or in collaboration with lawyers from other jurisdictions.

The first part of the report contains a brief discussion of the possible motivations for examining the international dimension of risk for a law firm and suggests how this might translate into explicit objectives for a firm’s international risk management strategy. Following a brief discussion of various risk management standards, the report goes on to adapt the ISO 31000 approach into a framework that is relevant for law firms. It takes the three step risk management approach of ‘identify’, ‘assess’, and ‘manage’, and works through this model systematically, applying it to the real-life environment in which law firms work internationally.

The second part of the report deals with the first of these elements – risk identification – and provides a discussion of the most important and most frequently encountered risks internationally. Advice is given on how to approach the identification of international risk in a structured way, working through the well-known PESTLE model for mapping the external environment and using a combination of value chain and market analysis tools to map the firm’s own internal risks. This is supplemented with some discussion of the specific events that may trigger risks for the firm.

The third part of the report looks at how the risks identified can be practically assessed and managed. It provides a brief overview of some of the methodologies most commonly used for quantifying risks and recommends a couple of very simple approaches to risk evaluation that will be sufficient for the needs of most law firms. The report then reflects on the essential issue of governance arrangements for risk and how individuals operating in different cultural environments in different parts of the world can be actively engaged in risk management.

The Appendix sets out a summary law firm international risk management model. The report also includes comparative tables, which show the top risk issues for law firm managing partners and others in different parts of the world.

As law firms focus on international work for long term growth, the importance of a clearly defined and actionable risk management approach will only increase. This practical report is designed to help law firms in establishing and implementing an effective international strategy for risk and compliance.
About the author

ALISON HOOK is managing director of Hook International, a specialist legal market consultancy which provides strategic advice to regulators, law firms, and other players in the legal sector. Her previous roles have included head of the international department at the Law Society of England and Wales, deputy head of the European Commission’s representation to the UK, and as a member of the cabinet of former European trade commissioner Sir Leon Brittan, in addition to various diplomatic posts in the Foreign and Commonwealth Office.

Alison left the Law Society in London to set up her own international consultancy practice, Hook International. They specialise in advising on cross-border regulatory issues, market access, international law firm strategy, and business development.
I AM grateful to my colleagues Katherine Bird and Kirsten Trott for their help in preparing this report. Any outstanding errors or omissions are entirely my responsibility.