

**LEXCEL: MANAGING RISK SO YOU DON'T HAVE TO**

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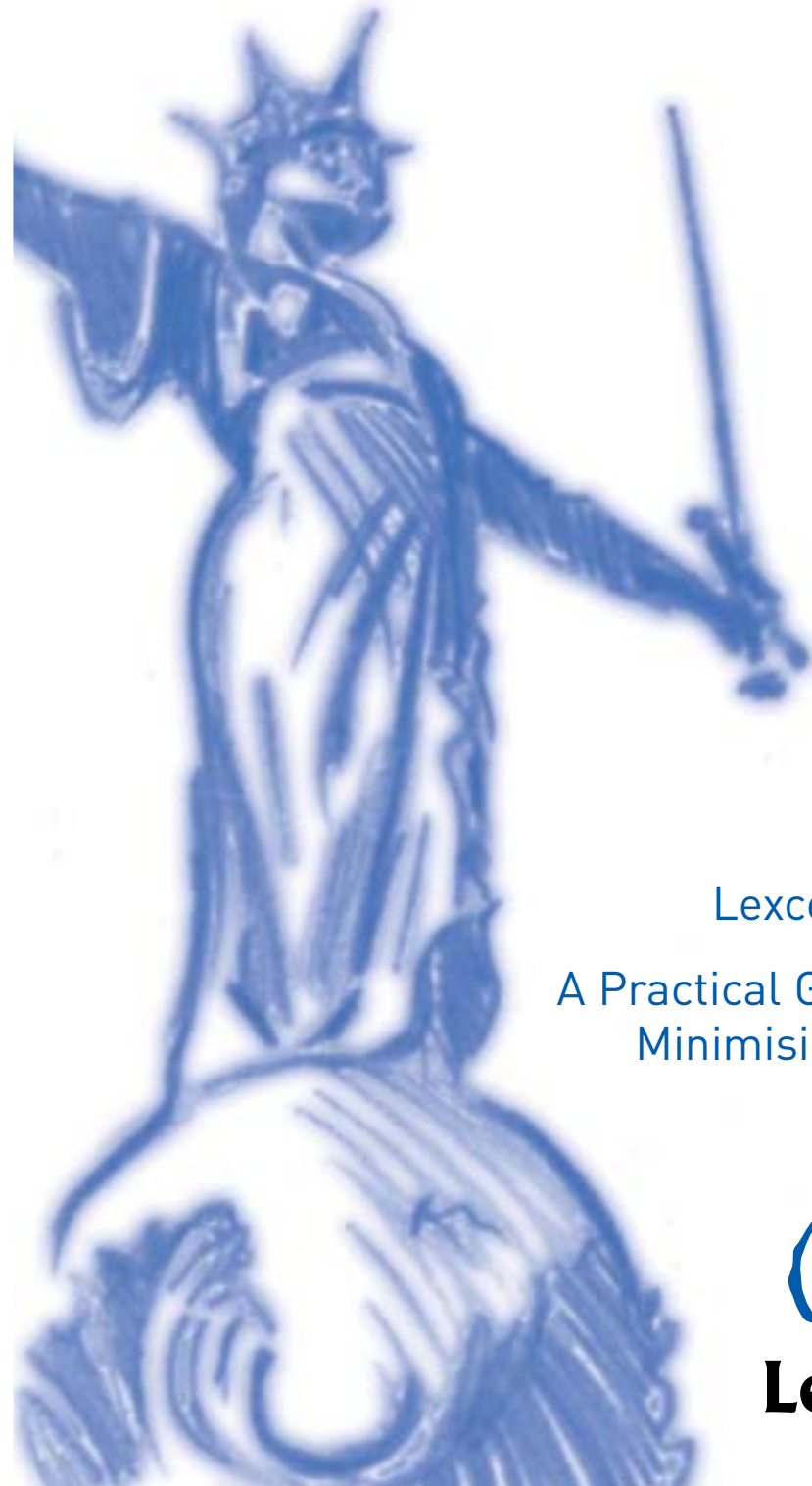
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Lexcel: **2004**

A Practical Guide to  
Minimising Risk



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**“Legal Risk believes that the Lexcel Standard 2004 provides an ideal framework for practices in all sectors to improve their risk management, not only in terms of professional indemnity issues but across the entire enterprise. If they follow it rigorously they will obtain an improved return on their investment in people and other resources, be prepared for the unexpected and, overall, be more successful.”**

*Frank Maher, partner in Legal Risk*

## INTRODUCTION

To many lawyers, risk management means avoiding professional indemnity claims. Although that will feature highly on the risk management agenda for most practices, and we deal with it below, that is not the full picture. First there are other potentially costly issues to avoid, such as employment claims and business interruption. Secondly, the way in which your firm manages its risk can be a far wider and more positive concept – making the practice more profitable and successful – rather than just avoiding the downside of losses.

Risk may be defined as the potential for loss through inability to meet your business objectives. By way of example, a claim for discrimination resulting in a large award of compensation, probably uninsured, may mean the firm fails to achieve its profit target and faces disciplinary action with reputational damage. So too, a firm's failure to discover partner dissatisfaction through an effective appraisal may lead to the loss of a department with long term damage to the firm.

A positive approach to managing risk involves addressing the areas of law and geographical areas in which the firm practises, the type of clients it wishes to serve, and the way it delivers its service to them through managing its people, assets and business processes.

This guide aims to show how the Lexcel Standard 2004 can help you achieve success.

## PRINCIPLES OF RISK MANAGEMENT

Effective risk management requires –

- Responsibility at senior management level;
- A framework for managing risk across all parts of the business – 'joined up' risk management;
- Integration of the risk management processes into everything the firm does – a culture, not an event – so although you appoint a senior person to be in overall charge of risk management, everyone knows that it is their responsibility too.

- Accountability in each practice area and support functions, such as accounts, IT and Human Resources;
- A risk evaluation process;
- External assessment;
- Business continuity planning.

These are all addressed by Lexcel. Provisions from the Standard which are particularly relevant are referred to in square brackets, though it will be appreciated that a firm-wide risk management system means that in reality there may be other provisions which are also relevant. For example, a claim arising from a missed time limit will show a failure of the diary systems but may also be due to an individual being overworked or having insufficient supervision.

**Those provisions which are most relevant to a basic risk management system are set out at the end of this guide for convenience. Nonetheless the sections omitted form part of a high level quality system and this guide should therefore be read in conjunction with the full Lexcel brochure and the Lexcel Assessment Guide – both of which contain the full requirements of the Lexcel Practice Management Standards.**

First, we look at professional indemnity issues as these are inevitably foremost in your mind.

## PROFESSIONAL INDEMNITY – COVER AND CLAIMS

When you apply for insurance cover, insurers take many factors into account in assessing the risk – that is, the risk that they will have to pay out on claims.

Your professional indemnity insurer takes account of your claims record and the type of practice you have – the areas of law, the location of your office, the size of the firm, supervision levels and fee income, and the size of the excess. An insurer knows that a larger excess will not only save the insurer some of the cost of small claims but also focuses the firm's collective minds on means of avoiding larger claims too.

**George Cameron, a governor of the Institute of Risk Management, welcomes the new Lexcel Standard 2004 and the way Legal Risk are highlighting the positive business contribution which a properly implemented risk management programme can make.**

It may take a while for new risk management procedures to impact on your claims profile and this in turn explains why insurers may want to see the improvement in claims figures before making significant reductions in premiums. Increasingly however insurers are recognising that Lexcel can help improve your firm's risk: some insurers may quote lower premiums for Lexcel awarded firms.

Insurers are also increasingly making their own assessment of Risk Management within a firm. Proposal forms are growing as more and more questions are added to probe the management systems in place within a firm. Insurers are becoming less wholly reliant on claims history and more focused on the 'here and now' of effective risk management systems. Investigations into claims are no longer just focusing on the claim itself and the failures surrounding it, but taking a more holistic look into the practice's risk management systems in general, in part with an eye to whether they are prepared to insure the firm in future.

Good management systems can help you –

- minimise the risk of future mistakes
- manage client expectations better, reducing the incidence of claims and mistakes
- contain the cost of claims from past errors
- learn lessons from past mistakes

The Lexcel Standard 2004 incorporates a number of improvements which have been implemented after discussion with insurers, brokers and others with practical experience of risk management. Unlike other quality certification systems which are designed for a wide spectrum of business including manufacturing, Lexcel takes particular account of the practicalities of running a legal practice and the areas where problems actually occur.

**For ease of reference, this guide highlights areas of the Lexcel Standard 2004 that make it an even more effective risk management tool.**

## CLAIMS IN PRACTICE

Few claims arise from lack of knowledge of the law. In practice, most of the problems stem from poor administration and lack of supervision. These are some of the most common problems –

- failure to comply with time limits causes about 30% of claims and over 60% of personal injury claims [8.7b]
- communication problems, particularly costs disputes – firms have not given clients adequate information both at the outset and as the matter progresses, and when clients sue for fees this is met by an inevitable counterclaim [7.1, 8.5, 8.7d]
- other failures in communication such as not confirming instructions, not defining the retainer, not agreeing clear objectives, not giving clear advice and not recording advice given on the file [8.4]
- lack of supervision, and cases being handled at too low a level [6.2-4]
- delay, often caused by mental blocks or overwork [6.5, 8.7c]

When claims do arise, their prospects of being defended or minimised are significantly affected by internal procedures and compliance with them – not only the keeping of file notes and other records [8.4], but also the speed with which staff appreciate the need to involve insurers, and the effectiveness of complaints procedures.

Only too often, firms fail to learn from their mistakes. A missed time limit, for example, should result in an investigation to see how the back up system failed and what can be done to prevent a recurrence [6.7f, 7.3].

Claims also arise from failure by fee earners to appreciate the significance of the matter they are taking on – either because the matter is beyond their expertise or that of the firm, or because they fail to assess at the outset whether there is any benefit to the firm in acting at all [6.7, 6.8a-b]. By way of example, some of the largest claims arise from advising third parties on mortgages securing business debts, in practice usually wives securing the home for the husband's business, which is a relatively high risk area of practice; in many of those cases the firms concerned have not charged for the advice, kept no record of the advice with which to defend themselves, failed to consider whether there is a conflict of interest, and not opened a file [8.2-3].

Effective financial management can help identify problem areas [3.1-3, 6.3c]. Accurate data on live matters, uncluttered by those which should have been closed off, can show which case handlers are overworked, taking on too many more cases than they are closing, not progressing matters, failing to take holidays or failing to submit bills; it can also help identify client dissatisfaction which may be expressed in unpaid bills.

**Claims waste time and money – not only the excess and future insurance increases, but the time spent helping insurers and their solicitors.**

## BUSINESS RISK

Money laundering compliance is high on the risk management agenda for most firms given the criminal sanctions and potential civil liabilities [1.9]. Yet there are still firms who have not trained their staff adequately or at all despite the more onerous regime introduced on 1 March 2004. Training fee earners is not enough. All staff need some training and any support staff who deal with clients need more than just basic training.

Client vetting for money laundering compliance purposes also ties in with the firm's risk assessment on first instruction, looking for warning signs of clients whose expectations may be harder to manage, or who may not pay the bills, and either putting appropriate controls in place or referring them elsewhere [6.7-8].

The relevance of data protection legislation to ordinary business activity is also becoming steadily more apparent [1.11, 4.4c].

Increasingly firms are considering whether to convert to a Limited Liability

**“Zurich Professional recognises Lexcel as providing an ideal framework for good practice management. The Standard includes excellent requirements and recommendations for systems and procedures which, if complied with consistently and conscientiously throughout the practice, can help significantly to reduce exposure to complaints and claims.”**

*Andrew Nickels, Zurich Professional*

**“Successful underwriting is about insuring the right risks at the appropriate terms. A firm's claims experience is a great indicator of the past quality of the firm. But it is the procedures adopted by the firm now which will drive the claims experience in the future. When underwriters see that a firm has obtained Lexcel they know that they are taking their procedures seriously, which should in turn benefit the claims experience.”**

*Jonathan Davies, Assistant General Manager, St Paul*

Partnership in order to help manage their risk [1.1-2]. Business continuity is also featuring on the agenda for more firms – not only through fear of terrorist activity but also more mundane events, including health and safety issues, such as flood or fire, asbestos, power failure or chemical leak [1.12, 4.1a, 4.3, 4.4g]. Increasingly, clients want assurance that the service will continue in these circumstances. It is also an area in which insurers' interest is increasing.

Employment disputes, including discrimination and harassment, have proved costly to several firms and have potential disciplinary sanctions as well [5.1, 5.4e].

Internet and email misuse carries risks of criminal sanctions, seizure of computers, reputational risk, libel and employment issues.

Lateral hires of teams and individuals and other recruitment all have implications for both the profitability and reputation of the business and, particularly because of the successor practice provisions in solicitors' insurance policies, the firm's professional indemnity cover [5.3].

**The need to protect your firm's reputation should not be overlooked: a reputation built up over many years can be lost in seconds.**

**“Lexcel accreditation significantly enhances an underwriter's view of a risk, widens the choice of interested insurers and invariably benefits the insured in terms of price and continuity.”**

*Alan Towergate, Towergate Underwriting Group Ltd*

## MINIMISE RISK THROUGH THE PRACTICAL IMPLEMENTATION OF THE LEXCEL STANDARD 2004

Lexcel helps firms to address these issues by providing a framework for policies, procedures, processes and planning. These are underpinned by a system of checking that they apply in practice, and that they are kept under review as part of a process of constant improvement. This is then subject to external assessment.

Firms which are well managed have nothing to fear: the standard is a combination of common sense and good business planning which can form a useful checklist even for firms who decide not to submit themselves for assessment. Some of the more significant provisions for minimising risk are set out below.

### 1. Structures and policies

- 1.1 Practices will have documentation setting out the legal framework under which they operate.
- 1.2 Consideration should be given to the most appropriate business structure and this should be kept under review as part of the business planning process (section 2).
- 1.9 Practices will have documented procedures to ensure compliance with money laundering legislation. The documented procedures should cover:
  - a: The appointment of a 'Nominated Officer' usually referred to as a Money Laundering Reporting Officer (MLRO).
  - b: Reporting of suspicious circumstances within the practice and by the MLRO to the authorities.
  - c: Identification checking.
  - d: Partner and staff training in anti-money laundering awareness.
  - e: The proper maintenance of records.Any exemptions to these requirements must be stated in the practice's documented procedures.
- 1.10 Practices providing services to clients in relation to property transactions will have documented procedures in relation to the avoidance of involvement in mortgage fraud.
- 1.11 Practices will have a documented procedure in relation to data protection compliance issues.

### 3. Financial Management

- 3.1 Practices will document responsibility for financial management procedures.
- 3.2 Practices will be able to provide documentary evidence of their financial management processes, including:
  - a: Annual budget (including, where appropriate, any capital expenditure proposed).
  - b: Variance analysis conducted at least quarterly of income and expenditure against budgets.
  - c: Annual profit and loss or income and expenditure accounts (certificated or audited accounts).
  - d: Annual balance sheet.
  - e: Annual cash or funds flow forecast.
  - f: Quarterly variance analysis at least of cashflow.Financial management data is best evidenced by showing all appropriate data or paperwork to assessors, but practices may decline to do so if they wish. In such cases the assessor will consider other evidence that is available, including correspondence from the practice's auditors and interviews with the partners and/or managers.
- 3.3 Practices will have a time recording process which enables the accurate measurement of time spent on matters for billing purposes and/or management analysis of the cost effectiveness of work and the efficiency of the practice.

**"Lexcel is a good starting point for risk management in law firms. The process of achieving and maintaining Lexcel accreditation brings home to each and every employee and partner the central importance of both quality management and control of exposure to risk."**

*Hilary Battison of mutual fund managers Tindall Riley*

## 4 Facilities and IT

- 4.4 Practices will have a plan for IT use setting out the use of IT facilities within the practice and any planned changes. The IT plan should cover:
- c: A data protection compliance statement in relation to staff, clients and others and registration with the Information Commissioner.
  - g: Computer data and system back up, to the extent not covered in any disaster recovery plan.

The IT plan must address at least a period of the current or next 12 months and may form part of the practice's overall strategy documentation, the office manual, or a separate document.

## 5 People Management

- 5.1 Practices will have a plan for the recruitment, development and welfare of their personnel, including:
- a: Likely recruitment needs, whether for the practice as a whole, its departments or offices, which may form part of the practice's overall business plan or departmental or other operational plans.
  - b: Training and development.
  - c: Welfare and entitlements.
- 5.3 Practices will have procedures to deal effectively with recruitment into the practice, including:
- a: The identification of vacancies.
  - b: The drafting of consequential job documentation, usually in the form of a job description.
  - c: Methods of attracting candidates and applicants.

**"There is no doubt that good risk management will lead to lower professional indemnity insurance premiums in the future."**

*Nick Pointon, PYV - The PI Specialists*

- d: Selection methods used.
  - e: Storage of interview notes.
  - f: Provision of information by way of feedback to unsuccessful candidates.
  - g: Any use of medical examination and/or references.
  - h: Confirmation of job offers.
  - i: Maintenance of communication during the pre-joining period and starting instructions.
- 5.4 Practices will conduct an appropriate induction process to cover:
- a: The practice's aims.
  - b: Management structure and the individual's job responsibilities.
  - c: Terms and conditions of employment, personal and banking details for personnel records.
  - d: Initial and future training requirements.
  - e: Key policies, including equality and diversity and client care and office procedures.

**"Clearly Lexcel provides a highly appropriate framework for practices looking to find ways of improving their risk profile, compliance record or practice management processes."**

*Jane Ridley, Managing Director, Alexander Forbes Professions Consulting*

## 6 Supervision and Operational Risk Management

- 6.2 There will be a named supervisor for each area of work undertaken by the practice. A supervisor may be responsible for more than one area of work. The supervisor must have appropriate experience of the work supervised and be competent to guide and assist others.
- 6.3 Practices will have processes to ensure that supervision of all staff, both legal and support staff, is effective. Issues which should receive consideration may include:
- a: Checks on incoming and outgoing post, including e-mails and faxes.

**“Effective risk management is essential in reducing the chances of a successful claim against a practice. Any system or procedure, including Lexcel, which contributes to this should be viewed as a positive step by firms.”**

*Marsh Ltd*

- b: Departmental, team and office meetings and communication structures.
  - c: Reviews of matter print-outs in order to ensure good financial controls and the appropriate allocation of workloads.
  - d: The exercise of devolved powers in publicly funded work.
- 6.4 Practices will have processes to ensure the effective supervision of legal work, to include:
- a: The availability of adequate supervision.
  - b: Appropriate procedures to allocate new work and reallocate existing work if necessary.
- 6.5 Practices will have procedures to ensure that all those doing legal work check their files regularly for inactivity to avoid client dissatisfaction and possible claims arising from delay.
- 6.7 For the purposes of this section, operational risk management is the control and reduction of prosecutions, claims and client complaints against the practice. Practices will ensure that procedures are in place to:
- a: Designate one overall risk manager for the practice with sufficient seniority, to be able to identify and deal with all risk issues which may arise.
  - b: Establish appropriate reporting arrangements to ensure that risk issues are appreciated and addressed.
  - c: Maintain lists of work that the practice will and will not undertake including any steps to be taken when work is declined on grounds that it falls outside acceptable risk levels. This information should be communicated to all staff and should be updated regularly.

- d: Maintain details of the generic risks and causes of claims associated with the area(s) of work that is/are undertaken by the practice. This information must be adequately communicated to all staff.
- e: Manage instructions which may be undertaken even though they have a higher risk profile than the norm for the practice including unusual supervisory and reporting requirements or contingency planning.
- f: Conduct at least an annual review of all risk assessment data generated within the practice, including claims records, an analysis of client complaints trends and data generated by file reviews. The practice should identify remedial action, which should then be reviewed at management level in the practice.

6.8 Operational risk needs to be considered in all matters before, during and after the processing of instructions. Before the matter is undertaken the adviser must:

- a: Consider if a new client and/or matter should be accepted by the practice, in accordance with section 8.2 below.
- b: Assess the risk profile of all new instructions and notify the risk manager in accordance with procedures under 6.7 of any unusual or high risk considerations in order that appropriate action may be taken.

During the retainer the fee-earner must:

- c: Consider any change to the risk profile of the matter from the client's point of view and report and advise on such circumstances without delay, informing the risk manager if appropriate.
- d: Inform the client in all cases where an adverse costs order is made against the practice in relation to the matter in question.

**“Lexcel radically reduced the premium we had to pay for our professional indemnity insurance and we hope to get an even bigger reduction next time. Insurance company risk managers love firms with Lexcel and if overheads come down it has to be good for everybody.”**

*Lexcel awarded practice*

At the end of the matter the fee-earner must:

- e: Undertake a concluding risk assessment by considering if the client's objectives have been achieved and if the client could fairly complain or make a claim for damages in relation to the service provided.
- f: Notify the risk manager of all such circumstances in accordance with documented procedures without delay.

## 7 Client Care

- 7.1 Practices will have a documented policy for client care, which will include:
  - a: The practice's commitment to provide services to clients in an appropriate manner.
  - b: Procedures to ensure compliance with Practice Rule 15 and its accompanying code in relation to client care and costs information.
- 7.3 Practices will operate a written complaints handling procedure that:
  - a: Is made readily available and accessible to clients when it is apparent that they may wish to have recourse to it.
  - b: Defines what the practice regards as a complaint and sets out how to identify and respond to complaints.
  - c: Records and reports centrally all complaints received from clients.
  - d: Identifies the cause of any problem of which the client has complained, offering any appropriate redress, and correcting any unsatisfactory procedures.

Practices must conduct reviews at least annually of complaints data and trends, such review(s) forming part of the review of risk assessment under 6.7f above.

## 8 File and Case Management

- 8.2 Practices will document how decisions will be made whether to accept new instructions from existing clients or instructions from clients who have not instructed the practice before.
- 8.3 Practices will document their arrangements to ensure that conflicts of interest are identified and acted upon in an appropriate manner. Although this is a particular consideration when receiving instructions it may also be an issue later in the matter, as when third parties are subsequently joined in proceedings.
- 8.4 At the outset of the matter the fee-earner will establish:
  - a: As full an understanding as possible of the client's requirements and objectives (where incomplete this must be supplemented subsequently).
  - b: A clear explanation of the issues raised and the advice given.
  - c: What the fee-earner will do and in what timescale.
  - d: Whether the fee-earner is the appropriate person to deal with the matter or whether it should be referred to a colleague.
  - e: Method of funding, including the availability or suitability of insurance, trade union benefits, conditional or contingency fee arrangements, or costs insurance products.
  - f: Whether the intended action would be merited on a cost benefit analysis and whether, in public funding cases, the guidance in the funding code would be satisfied.

The issues covered in a-f above must be confirmed to the client, ordinarily in writing, unless it would be appropriate not to do so under the Solicitors' Costs Information and Client Care Code. In all cases a note of these issues must appear on the matter file.

- 8.5 Practices will ensure compliance with the requirements of the Solicitors' Costs Information and Client Care Code in relation to initial costs information and, in particular, the provision of the 'best information possible on the likely overall costs of the matter, including a breakdown

between fees, VAT and disbursements' (4a). Where there are special circumstances making the provision of this information inappropriate, the special considerations must be noted on the matter file. In relation to standing agreed terms with regular clients see section 7.2.

- 8.7 Practices will have documented procedures to ensure that matters are progressed in an appropriate manner. In particular:
  - c: A timely response is made to telephone calls and correspondence from the client and others.
  - d: Information on cost is provided at least every six months and, in publicly funded matters, the effect of the statutory charge, if any, is provided to the client in accordance with the Solicitors' Costs Information and Client Care Code.
- 8.8 Practices will document procedures for the giving, monitoring and discharge of undertakings.