

Risk management guide

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Introduction

Lexcel can help you manage risk more effectively than ever before. The new version of the standard incorporates a number of improvements which have been implemented after consultation with practices, consultants, insurers, brokers and others with practical experience of risk management. Unlike other quality accreditation systems, which are designed for a wide spectrum of industries, Lexcel focuses on the practicalities of running a legal practice and the areas where risks can occur.

Insurers recognise that Lexcel can be an effective risk management tool. In particular, Lexcel provides a framework for good management systems to help you improve your risk profile. This can assist as many claims arise as a result of poor administration and lack of supervision, as opposed to lack of knowledge of the law.

This guide will provide you with information about how to avoid professional indemnity claims and become more successful at managing risk.

Risk in this context is defined as the potential for loss through inability to meet your business objectives.

If you would like to receive a free Lexcel information pack, quarterly newsletter or advice on how it can help your legal practice, contact the Lexcel office via e-mail at: lexcel@lawsociety.org.uk

Factors determining your insurance premium

When you apply for insurance cover, insurers take many factors into account in assessing the potential risk that they will have to pay out on claims. Key factors considered are:

- Your claims record
- The areas of law you practice in
- The size of your firm
- The number and location of offices
- Supervision levels

- Fee income
- Your excess
- Your commitment to best practice and risk management
- Solicitors Regulation Authority (SRA) reports
- Professional disciplinary record

Principles of risk management

Effective risk management requires:

- Responsibility at senior management level
- A framework for managing risk across all parts of the business
- Integration of risk management processes into everything the practice does
- Accountability in each practice area and all support functions
- Regular review, evaluation and assessment of risks
- Business continuity planning and testing

Reasons for claims

Many claims stem from poor administration and lack of supervision. Common problems include:

- Failure to comply with time limits causes over 60% of personal injury claims and 30% across other areas of work
- Communication problems with the client
- Lack of supervision
- Cases being handled at too low a level
- Delay, often caused by inexperience, stress or overwork
- Breach of undertakings

Managing risk using the Lexcel framework

Lexcel will help you address risk issues by providing a framework for policies, procedures, processes and planning. These are all underpinned by a system of monitoring to make sure they are enforced and are incorporated into daily practice. Combined with regular reviews and assessments, the framework should help your practice identify and manage risks on a continuing basis.

The following Lexcel requirements have a primary focus of helping you manage risk:

- 1.1 Practices will have documentation setting out:**
 - (a) the legal framework under which they operate**
 - (b) their business structure**

The majority of firms have a partnership structure. The type of partnership may vary, for example Limited Liability Partnerships (LLPs). One of the other main types of legal framework is to be a sole principal.

If your practice has a partnership structure it is vital to have a partnership agreement in place. Failing to have a partnership agreement is clearly an area of risk, as it can impact on the viability of the practice in numerous and significant ways. The agreement should address issues including:

- Voting rights
- The authorisation of individual partners to bind the practice in contract
- Sharing profits
- Capital contributions and repayment
- Expulsion from the practice
- Retirement from the practice
- Working patterns
- Parental leave
- Long term illness or incapacity
- Succession
- Compliance with any relevant standards, for example Lexcel

A further issue for consideration is the impact of the Legal Services Act 2007 which will introduce changes, such as the ability to be a LDP from the 1 March 2009 and further down the line the introduction of Alternative Business Structures (ABSs). It would be a risk to fail to consider how these changes impact on your practice and whether or not you should consider altering your legal structure in the future. For example, if you have a finance manager that is not a solicitor but integral to the functioning of your practice and they wish to become a partner, would you risk losing them or consider changing your structure.

1.2 Practices will have a risk management policy, which must include:

(a) strategic risk

(b) operational risk

(c) regulatory risk

For ease of reference this guide considers strategic, operational and regulatory risk in turn. There are a number of themes and issues which are captured under more than one heading, depending on the particular circumstances. Provided that your practice gives the issue(s) due consideration and takes steps to manage the risk it is of secondary importance how you categorise it.

(a) Strategic risk – viability and success of your practice

The strategic element of your risk policy is likely to result from your business planning process. Practices should consider conducting a Strength Weakness Opportunity Threat (SWOT), Political Economic Social Technological (PEST) or Political Economic Social Technological Environmental Legal (PESTEL) analysis. These tools can help identify areas of potential challenge or development and can be fed into your policy.

Elements for you to consider in your analysis are:

- Financial decisions
- Succession planning
- Client development opportunities
- Attracting and retaining clients
- Reliance on key clients for fees
- Competition
- Economic climate
- Reputation

The information produced should be considered and then fed into your risk policy. The incorporation of these details will help to ensure staff across the practice are aware of the risks for your practice and help to manage them.

(b) Operational risk – the cost of making mistakes

As well as having a policy to manage operational risk, Lexcel has an entire section devoted to operational risk and supervision (section 6) as it is of such importance to practices. It will be considered on pages 6 to 11 in this guide.

(c) Regulatory risk – failure to comply with the law and regulation

The law and regulations that impact on you as a law firm change on a regular basis. It is vital that you keep yourself up-to-date with these changes. Some of the areas that are fundamental and need to inform your risk policy are:

- The Solicitors Code of Conduct 2007
- The Solicitors Accounts Rules 1999
- Money Laundering Regulations 2007
- Proceeds of Crime Act 2002
- Terrorism Act 2000
- The Data Protections Act 1998
- Legal Services Act 2007

Accountability is fundamental to the success of a risk management strategy. For Lexcel, practices are required to have a named person who is responsible for the risk management policy. This person will need to keep up-to-date with developments in risk management and amend the policy when appropriate.

A further basic principal of risk management is to conduct regular reviews. Lexcel requires all policies to be reviewed at least annually. Regular reviews

will help to satisfy the practice that the policy is functioning effectively and remains relevant to the business.

1.4 Practices will have a policy on the avoidance of discrimination and the promotion of equality and diversity, to include:

- (a) employment and partnership, recruitment and selection, training and conditions of service and promotions within the practice**
- (b) the delivery of service**
- (c) the instruction of counsel and experts in all professional dealings**

Laws prohibit discrimination on the grounds of racial or ethnic origins, disability, age, gender, sexual orientation and religion or belief. Anti-discrimination legislation is designed to promote equality and fairness in relation to employment and the provision of services.

Diversity is a broader concept that builds on the progress made through equal opportunities.

Unlawful discrimination can be costly in financial and reputation terms to a practice. There is no limit to how much an employment tribunal can require a practice to pay someone if the practice has been found, as an employer, to have discriminated against an employee. Employers are also responsible for the actions of their employees so it is important that employees know what is expected of them.

Discrimination, equality and diversity policies are intended to support both employee and employer. Employees should take comfort that their employer is seeking to follow best practice and identify issues which may affect them as individuals. Employers will help create a fair and equal workplace while collecting evidence to demonstrate good practice.

The purpose of reviewing this, and indeed the review of most of the policies contained in Lexcel, is to look for evidence of the effectiveness of the policy, identify existing and emerging trends, and to ensure that the policy is being communicated properly to staff.

1.5 Practices will have a policy to ensure compliance with anti-money laundering legislation. The policy must include:

- (a) the appointment of a Nominated Officer usually referred to as a Money Laundering Reporting Officer (MLRO);**
- (b) a process for making disclosures within the practice and by the MLRO to the authorities;**
- (c) identification checking;**
- (d) training of personnel;**
- (e) the proper maintenance of records.**

For guidance on anti-money laundering compliance please see the Law Society's practice note on anti-money laundering at:

<http://www.lawsociety.org.uk/productsandservices/practicenotes/aml.page>

In addition you can contact the Law Society's free Practice Advice Service (PAS). Contact PAS via phone on: 0870 606 2522 or e-mail at: practiceadvice@lawsociety.org.uk

For Lexcel compliance, it is necessary to review the practice's anti-money laundering policy. When reviewing the policy, issues that should be considered are:

- Levels of reporting by office or department
- Training that has been done and is needed
- Whether any breaches of the regulations occurred
- Whether any significant incidents arose

1.6 Practices providing services to clients in relation to property transactions will have documented procedures in relation to the avoidance of involvement in mortgage fraud.

For guidance on this subject, see the Law Society's practice note on Mortgage Fraud at:

<http://www.lawsociety.org.uk/productsandservices/practicenotes/mortgagefraud.page>

2.4 Practices will have a business continuity plan, which must include:

- (a) an evaluation of potential threats and the likelihood of their impact;**
- (b) ways to reduce, avoid and transfer the risk;**
- (c) processes for testing and checking the plan.**

A business continuity plan is a key risk management tool that has been part of the Lexcel standard since March 2007. This requirement is now an obligation under the Solicitors' Code of Conduct 2007 which came into force on 1 July 2007.

When drafting a business continuity plan it is worth considering the skills you need to implement the plan and which staff possess these. It is also vital that there are clear communication channels so that staff and clients can be informed of any interruptions to the business. An important part of your business continuity plan is likely to be the backup and retrieval arrangements that you have in relation to IT.

In addition, you should give consideration to your practice's location, workforce and the risks that could realistically impact on the continuity of your business. Once you have identified the risks to your practice you must give consideration to how these risks can be reduced.

To help manage risks, practices should consider analysing:

- How you initially assess the disruptive situation
- Preferred method of protecting staff, clients, equipment, information and records

- How to report emergencies
- How to warn employees
- An evacuation plan
- How to decide whether or not to shut down operations
- How to shut down operations
- How internal and external communications are to be handled

A key feature of this requirement is to test the plan to ensure that it works. This can be conducted in a variety of ways and should be based upon what is relevant for your practice. The level of your testing will depend on your resources but the test should be conducted as effectively and realistically as possible. For example, you may simulate a disaster, test that the IT backup works and the information can be readily retrieved. Alternatively, you may wish to test the communication channels to ensure that contact details are current.

For guidance on compliance please see the Law Society's practice note on business continuity at:

<http://www.lawsociety.org.uk/productsandservices/practicenotes/businesscontinuity.page>

6.1 Practices will have a written description of their management structure which designates the responsibilities of individuals and their accountability.

As mentioned in the introduction, accountability among personnel is vital to implementing an effective risk management framework. This helps everyone to understand their role and responsibility in managing risk. Where practices have a relatively complex management structure, this can also help save time when issues occur as everyone knows who to contact.

6.2 There will be a named supervisor for each area of work undertaken by the practice. The supervisor must have appropriate experience of the work supervised and be competent to guide and assist others.

This information may be collated with the information required in 6.1. In addition, thought should be given to ensuring the supervisors are competent. Some of the issues you may want to consider when designating a supervisor are:

- Experience
- Seniority
- Communication skills
- Availability
- Accessibility
- Workload

6.3 Practices will have processes to ensure that all personnel, both permanent and temporary, are actively supervised. Such processes will include:

- (a) checks on incoming and outgoing correspondence, including letters, e-mails and faxes;**
- (b) departmental, team and office meetings and communication structures;**
- (c) reviews of matter details in order to ensure good financial controls and the appropriate allocation of workloads;**
- (d) the exercise of devolved powers in publicly funded work;**
- (e) the availability of a supervisor;**
- (f) allocation of new work and reallocation of existing work, if necessary.**

Regular supervision helps practices to control the implementation and use of their policies and procedures. This in turn can often identify staff development and performance issues.

Good communication is vital to effective risk management and having regular meetings with staff both as a team to help share knowledge. One-to-one level meetings should also help foster good communication.

It is important that staff should be able to raise issues that they are concerned about with their supervisor. This will assist in minimising the risk of staff hiding problems, particularly if there is a blame culture within the practice. When practices are faced with economic challenges, this can be particularly important. Staff may be more prone to enhanced levels of anxiety over the quality and quantity of work, which may result in an increased risk of errors and complaints.

Practices should be aware that the onus is on the supervisor to be available and to actively supervising staff. This includes ensuring that those under supervision have a manageable workload and work being done is at an appropriate level.

Supervising e-mails can be a challenge, particularly due to the increasing volume of electronic communication. Practices can supervise e-mails in a variety of ways. Some practices may decide to supervise e-mails in a similar way to post, while others may decide that it is not feasible to do this as the volume of e-mails is too great. In this situation, practices may opt to only have e-mails checked prior to sending if they relate to a matter file which has been designated high risk.

6.4 Practices will have procedures to ensure that all those doing legal work check their files regularly for inactivity.

Ensuring that matters are not delayed will reduce the likelihood of client dissatisfaction and claims. These checks should be done by the person responsible for the matter. It is good practice, however, for the supervisor to discuss matter lists with their supervisees on a regular basis which can assist in avoiding un-necessary delays.

6.5 Practices will have procedures for regular, independent file reviews, of either the management of the file or its substantive legal content, or both. In relation to file reviews, practices will:

- (a) define file selection criteria;**
- (b) define the number and frequency of reviews;**
- (c) retain a record of the file review on the matter file and centrally;**
- (d) ensure any corrective action which is identified in a file review is actioned within 28 days and verified by the reviewer;**
- (e) ensure that the designated supervisor reviews and monitors the data generated by file reviews;**
- (f) conduct a review at least annually of the data generated by file reviews, which will contribute to the review of risk assessment data.**

For Lexcel, practices must decide how files will be selected for review. The files may be selected randomly or targeted for a particular reason. For example, files may be chosen that relate to high risk matters, or in a way that highlights an individual's spectrum of work.

File reviews need not be undertaken by the designated supervisor in person, provided they are aware of the outcome of the file reviews. All matter handlers need to be involved in the file review arrangements, including partners. This practice-based approach will help maintain a consistent level of risk management throughout the entire organisation.

The frequency and depth of reviews should reflect the fee earners:

- Experience of the area
- The outcome of previous file reviews
- Average life of matters
- Proportion of high risk matters
- Overall work load

The review will generally embrace technical and procedural issues but in some circumstance it will only be possible to conduct a procedural review. This will be most common in sole practices or niche areas of larger practices where there is no prospect of another person within the organisation having the necessary expertise to assess the technical content of the file.

File reviews will also highlight corrective action that is needed and record when it has been completed. Corrective action will need to be checked by the reviewer.

The mechanism for the corrective action is for the practice to decide. It should help promote learning and reduce the risk of errors which may lead to complaints. Practices should take into account that the corrective action must take place within a maximum of 28 days following the file review.

6.8 Operational risk will be considered and recorded 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 8.2 below;**
- (b) assess the risk profile of all new instructions and notify the risk manager in accordance with procedures under 6.6 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.**

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.**

With regards to Lexcel, an initial risk assessment should be based on the instructions received and must be recorded. Practices should identify the different levels of risk for their organisation. Higher than normal risks should then be referred to the risk manager via a procedure established for doing so. This may be undertaken in a variety of forms. For example, a section in the matter opening form highlighting 'high' or 'unusual' risk associated with the instructions, or by an entry in the risk register.

During the retainer the on-going risk profile should be considered. It is only necessary to record the risk during the matter if it has changed from the initial risk category. If the risk to the client or the firm changes materially – for example, third parties are joined in litigation, materially adding to costs risks, or counsel's opinion is obtained casting doubt on advice already provided to the client – the client will need to be informed and consulted without delay. Adverse costs orders need to be reported immediately as they will usually have to be paid forthwith.

At the end of the matter the fee earner should consider whether the risk profile is the same as at the outset. This is not as simple as looking at whether the transaction or litigation succeeded or not. It is essential to consider whether you would want to take similar instruction in the future.

Summary

When risks arise, the prospect of minimising their effects are significantly impacted by internal policies, procedures, plans and processes - and the practice's compliance

with them. Only too often, practices fail to identify realistic risks or learn how to mitigate them.

A missed time limit, for example, should result in an investigation to see how the system failed and what can be done to prevent a recurrence.

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. 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.

Effective financial management can help identify problem areas. 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 providing information to the insurers and their solicitors.