

■ Systemise your compliance: can you afford not to?

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Since the introduction of outcomes-focused regulation in 2011, Peter Scott has been advocating to law firms that they should systemise the management of their compliance by using IT to streamline the identification, monitoring, assessment and mitigation of risks

Unfortunately, this is not happening in many law firms. Instead, risk and compliance management is all too often ad hoc, limited to 'firefighting' problems that have already occurred, and lacking overall planning.

Why is this? I suspect there are two main issues, both of which can be dealt with if the management of risk and compliance is systemised.

Not seen as a priority but as a burden with no benefit

Risk and compliance management is still not seen by enough law firms as a priority, but instead is too often viewed as a burden. If systemised, the burden can be ameliorated and, if managed well, it can make positive contributions to the success of a law firm as the two following quotes illustrate:

'We manage our risks in the way we do in pursuit of excellence with the aim of doing things better for clients.' (Director of risk of a top 10 law firm)

'It has got to make financial sense, but you have to see risk management as one of your strategic objectives. Business resilience is actually a competitive advantage.' (Cedric Lenoire, head of FM Global's business risk consulting division, as quoted by Miles Costello in *The Times*, 21 January 2013)

Inability or unwillingness to incur cost

When I asked the audience at a risk and compliance conference recently why each of their firms did not have a team of risk and compliance professionals, the overwhelming answer given was 'We can't afford it,' to which my response was 'Can you afford not to?'

As a result of unwillingness (usually because no resulting benefit is perceived) or inability to incur cost (because of financial instability issues), insufficient resources in the shape of financial spend and people's time are applied to risk and compliance management. For many compliance officers for legal practice their role involves spending just a few hurried hours per week when, if they are to perform the role effectively, they should actually be devoting a substantial amount of their time to managing risks and compliance. This can be a problem in all law firms, but is a particular issue in small firms that often lack sufficient manpower of the appropriate experience or quality for the job and in which a partner's time spent on so-called 'non-chargeable' tasks can put a large dent in a firm's earnings.

What steps can firms (and smaller firms in particular) take to reduce the amount of their time required to carry out effective risk and compliance management? The answer to this resource

problem points to the use of IT to systemise risk and compliance management as an obvious solution.

Where are the comprehensive IT systems to help?

This to my mind is the crucial issue if law firms are to be persuaded that their risks and compliance can be cost-effectively managed and need not be a burden and a drain on resources. Using IT as a tool to help a law firm manage its risk and compliance is such an obvious thing to do that I would like to think that software suppliers to the legal profession have built comprehensive risk and compliance capabilities into their systems for use by their law firm customers. Sadly, to date, with only a few exceptions as far as I can see, this does not appear to be the case. If I have missed something and am doing a disservice to software suppliers then I would ask them to please step forward, as many law firms would like to hear from them!

For example, a few months ago I was being given a demonstration of a practice management system and I asked whether the system had the capability to monitor compliance requirements such as the carrying out of anti-money laundering procedures in relation to each client matter. To my surprise I was shown what the system could do, which was precisely what I was looking for. I then asked whether the system could also monitor other compliance requirements such as risk assessments and conflict checks, but was told by the representatives that they had never thought about this. To their credit, they asked me to explain conflict checking and its importance and by the end of the meeting were committed to making it a priority to introduce that capability to the system. They were also planning to look at other compliance procedures in turn with a view to ensuring their system had a more comprehensive capability.

Revealingly, when I asked them why they had not incorporated these features before, they replied that no law firm had ever asked for such capabilities! There I suspect is a main source of the problem. While providers of software to the legal profession usually have active user groups, so ensuring that they understand users' needs, it is likely that it is law firms who have not made known their risk and compliance needs to software suppliers.

What are the priority challenges for law firms in respect of managing risks and compliance and how can systemising risk and compliance management help address these challenges?

A survey of law firms carried out in 2014 by the International Legal Technology Association found that 64 per cent of firms surveyed said that aligning IT solutions to their business needs was a top priority. However, only 49 per cent of the firms surveyed mentioned increasing their focus on risk management.

Compare those findings with a recent survey of the issues which most concern corporate general counsel (who tend to be very risk averse) over the next 18 months. Almost 60 per cent

said that regulation and compliance was their top priority, 70 per cent had strengthened policies and procedures and 28 per cent had already implemented software tools to help them manage regulatory risks (source *Global Legal Post: The Law Department of the Future and General Counsel Excellence Report 2015*). I would suggest that law firms should learn from and adopt the attitudes of general counsel when it comes to managing risk and compliance.

The need to systemise risk management and compliance is clearly recognised by the outcomes listed in chapter 7 of the SRA Code of Conduct. For example, outcome 7.2 requires firms to have appropriate systems and controls in place to achieve and comply with all the principles, rules and outcomes and other requirements of the Handbook; and outcome 7.3 requires that firms identify, monitor and manage risks to the achievement of all outcomes, rules, principles and other requirements in the Handbook if applicable to them and take steps to address issues identified.

The priority risk and compliance challenges for law firms should therefore include:

- **knowing and assessing** their risk and compliance issues;
- **monitoring and reviewing** the effectiveness of their risk and compliance control procedures; and
- **resourcing** them in the most cost-effective manner (given that resources are always scarce) by systemising the processes using IT.

How can law firms cost-effectively deal with these? I would suggest that initially a firm should carry out a cost/benefit analysis to establish the most cost-effective method to resource risk and compliance management. That will then need to be followed up by developing processes to do this by changing the way people view managing risk and compliance (i.e. as a benefit not a burden), how they work as lawyers and, in particular, how they can use technology to systemise those processes.

In an ideal world I would like to see law firms have available to them technology which is integrated with the other systems they use to enable them in a comprehensive manner:

- to streamline the identification, monitoring, assessment and mitigation of risks of every type;
- to create and maintain a central and up-to-date risk and compliance database;
- to embed risk and compliance monitoring procedures into their operations; and
- to provide information access to all who need it in relation to a firm's exposure to risks.

The areas of risk and compliance management which firms should focus on as priorities to be systemised are the following.

Identifying and assessing high-incidence, high-impact risks

Client inception and matter inception vetting procedures lend themselves to the effective use of technology, which can both identify and help to assess risk issues for a firm at the outset of a matter. The use of technology can also build in control measures to prevent risks crystallising and compliance breaches occurring.

Taking on new clients can be a particular area of risk which needs to be closely controlled and assessed. A firm will also need to assess the risks associated with taking on certain types

of complex or high-value work with a view to reducing the possibility of claims for negligence.

Some law firms have developed their own online client and matter level risk questionnaires which can be effective in identifying and then helping to assess and manage operational risks and, as a result, reduce both professional indemnity costs and the risks of compliance breaches. Such online questionnaires use the responses to score the level of risk so as to give each client/matter a risk rating. If the risks associated with acting for a client or on a matter are rated as being unacceptably high, then it is likely that the firm will decline to act. Lower risk ratings will determine the levels of management and supervision to be applied to the client/matter. One firm which uses an online risk questionnaire of the type referred to above has not had a negligence claim made against it in the 10 years it has been using the tool, which demonstrates how effective and valuable such a tool can be.

Whether or not such a risk assessment tool is used, a firm should ideally have its procedures and controls for vetting clients and matters embedded into its systems in such a way that they cannot be bypassed. Using a firm's IT systems appropriately can prevent matter files being opened, unless and until all required procedures have been complied with, including:

- client and matter vetting;
- anti-money laundering/identity checks;
- credit checks/money on account;
- conflict of interests checks; and
- engagement letter and business terms sent and signed copy returned.

However, it can prove more difficult to stop partners and other fee earners 'jumping the gun' to work on matters even before a file is opened, but preventing that will depend on the management, education and training of staff so they understand the serious risks involved in doing so. Ultimately, only sanctions may prevent such behaviour.

Monitoring the effectiveness of risk and compliance procedures

Continuous monitoring of a firm's risk and compliance management is vital, but it is the area where technology currently would seem to be least used even though it can have the most beneficial impact.

Indicative behaviour 10.1 in the SRA Code of Conduct provides that:

'Actively monitoring your achievement of the outcomes in order to improve standards and identify non-achievement of the outcomes, may tend to show that you have achieved these outcomes.'

However, it is the need to be able to demonstrate compliance which is all important; just being compliant is insufficient: 'If you cannot demonstrate compliance, we may take regulatory action' (Solicitors Regulation Authority (SRA), *OFR at a Glance*, 2011). This is where technology can come into its own by embedding the monitoring of procedures into a firm's IT systems so that everything is recorded, enabling a firm to measure and document effective risk and compliance management on an ongoing basis.

The procedures and matters which can be captured by a firm's systems for the purposes of ongoing monitoring and reporting should include:

- financial stability;
- SRA Accounts Rules 2011;
- client and matter risk assessments;
- anti-money laundering/identity checks;
- credit checks/money on account;
- conflict of interests checks;
- engagement letters;
- costs information;
- supervision;
- complaints;
- undertakings;
- file closure;
- training (particularly important with the advent of the new continuing competence requirements); and
- compliance with statutory regulations of the kind every law firm has to deal with, including equality and diversity, employment law, data protection, Bribery Act 2010 and health and safety.

Methods of monitoring

Every law firm should already have developed its own methods of monitoring and assessing the effectiveness of its risk control procedures against the objectives it will have set itself. Those monitoring methods can also be embedded into a firm's IT systems so it can demonstrate how it has gone about monitoring its risk and compliance management and how effective its control procedures have been. These are likely to include monitoring methods such as:

- file reviews;
- auditing for purposes such as Lexcel accreditation;
- voluntary reporting of risk issues;

- positive self-certification of compliance with stated procedures;
- whistleblowing arrangements; and
- the regular consideration and assessment of risk issues reported, actions taken and responsibilities assigned.

The value of embedding risk and compliance procedures into an IT system in this way and incorporating ongoing monitoring and assessment is that:

- it can enable a firm to build a universally applicable risk and compliance database so the firm can better know where there are risks in its organisation (knowledge management is key to effective risk management);
- a structured approach such as this can help to focus a firm on the key risk and compliance issues;
- continuous monitoring helps to ensure more effective management of risks and compliance and they are 'lived' on a daily basis;
- a firm will be better able to demonstrate the effectiveness of its risk and compliance management; and
- it should create a level of comfort for professional indemnity insurers and possibly the SRA and other regulators.

And in addition to all those benefits, systemising risk and compliance management by the use of IT should go a long way to resolving the resource problem with which so many firms are struggling and which, if not adequately dealt with, will mean that law firms are more 'at risk' than they need to be.

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