CLC
Regulating Property And Probate Lawyers

Council for Licensed Conveyancers

Risk Agenda 2023

www.clc-uk.org

Welcome to the Council for Licensed Conveyancers' Annual Risk Agenda.

The community of specialist conveyancing and probate lawyers that the CLC regulates carries a huge responsibility for ensuring that clients' money and other assets are kept secure while those clients go through major life events such as moving home or losing a loved-one.

This, the third of our annual Risk Agendas aims to help CLC-regulated lawyers meet the challenges of legal practice in the fast-changing world and to protect their clients.

We would be very pleased to hear from you about items that you believe should appear in the next edition of the Risk Agenda.

Hundreds of millions are laundered through conveyancing across the UK

Anti-money laundering

Anti-money laundering (AML) is always a high priority for the CLC and government alike, and Russia's invasion of Ukraine has placed an even greater spotlight on it and the role of the property market in 'cleaning' dirty money.

The Economic Crime and Corporate Transparency Bill currently going through Parliament will ratchet up requirements across the economy, including adding a new specific regulatory objective to the Legal Services Act 2007 that will require regulators to promote the prevention and detection of economic crime.

Speaking during the Bill's committee stage in the House of Commons last year, security minister Tom Tugendhat explained: "His Majesty's government's national risk assessment for 2020 assessed the legal services sector as being at high risk of exposure to money laundering. The crisis in Ukraine has highlighted that the sector is exposed to further-reaching risks, such as sanctions breaches. The Bill therefore contains measures that strengthen the legal sector's response to economic crime.

"Our legal sector is internationally renowned for its high standards of excellence and professional conduct. The vast majority of the sector is compliant with its economic crime duties. However, it is crucial that regulators have the right tools to effectively promote and monitor compliance.

"The clause puts it beyond doubt that it is the duty of legal services regulators to take appropriate action to ensure that their regulated communities comply with economic crime rules. It will give frontline regulators a clear basis for any supervision or enforcement action they may carry out to uphold the economic crime regime."

The government is setting very clear expectations of both regulators and those they regulate – licensed conveyancers need to understand just how high a priority tackling economic crime is.

Your duties are laid out in the Anti-Money Laundering (AML) and Combatting Terrorist Financing Code and the Money Laundering Regulations 2017 (as amended). To best understand their application to the legal sector, read the guidance from the Legal Sector Affinity Group (LSAG), which the CLC is a part of. A reminder of the key changes contained in the Fifth Money Laundering Directive can be found here.

The LSAG comprises both the regulatory and representative bodies for legal services in the UK, including the CLC. It has produced official guidance on the Regulations, which is approved by HM Treasury. This is part of the collaborative working across the sector that the CLC is involved in, with the Legal Services Board also playing an important role.

The CLC additionally takes specific AML action based on our specialist knowledge. We encourage you to read the CLC's Anti-Money Laundering Report 2022, which sets out in greater detail our work with practices to improve AML compliance, the themes that emerge from our inspections and other valuable information. This annual report is a requirement of Regulation 46A of the Regulations and is a useful resource for practices.

The CLC, along with the other relevant regulators in the legal sector, is also overseen by the Office of Professional Body Anti-Money Laundering Supervision, whose goal is both to ensure a robust and consistently high standard of supervision by us and to facilitate collaboration and information sharing.

One issue that has emerged recently is the Money Laundering Reporting Officer (MLRO) acting on one side of a transaction where the practice is acting on both sides, and the problem that arises should there be an AML issue which requires disclosing to the MLRO. We discuss this in the section on conflicts of interest, but the key message is that the MLRO needs to remain independent.

Another issue we have identified in inspections is that practices do not include donors in their AML policy or apply the same checks for donors as for clients and we have also found issues with ensuring that beneficial owners and corporate structures are appropriately identified and/or included in a practice's AML policy.

A recurring issue which the CLC has identified is inadequate AML policies and procedures. Practices must be aware that these policies are crucial to your overall AML approach and will often have a significant influence on other areas of compliance, such as in client due diligence. A comprehensive and updated AML policy is a crucial step in discharging your AML obligations.

Source of funds and wealth

This is a significant issue at all times but particularly so at the moment. It is difficult to understand the source of funds without understanding the source of wealth – conveyancers should realise that these two concepts are not mutually exclusive.

The LSAG Guidance says:

Source of Wealth *refers to the origin of a client's entire body of wealth (i.e., total assets). SoW describes the economic, business and/or commercial activities that generated, or significantly contributed to, the client's overall net worth/entire body of wealth. This should recognise that the composition of wealth generating activities may change over time, as new activities are identified, and additional wealth is accumulated.*

Source of Funds *refers to the funds that are being used to fund the specific transaction in hand – i.e., the origin of the funds used for the transactions or activities that occur within the business relationship or occasional transaction. The question you are seeking to answer should not simply be, "where did the money for the transaction come from," but also "how and from where did the client get the money for this transaction or business relationship." It is not enough to know the money came from a UK bank account.*

Our inspections have discovered different interpretations of what practices have to do and the evidence they need to obtain to ensure they are complying with their duty to check the source of a client's funds and wealth. One of the most common misinterpretations we see is practices concluding that merely obtaining a bank statement, or 'proof of funds', is sufficient when they are obligated to go further and establish the source of the funds in question.

We would expect practices to investigate and satisfy themselves that the clients' reported income and wealth aligns with the documentation and information the practice has been given. For example, does their income and wealth correlate with their job role? Information must be verified with evidence, rather than simply taking clients' assertions or making assumptions based on clients' profiles. The extent of the evidence required to verify the source of the funds or wealth will vary from case to case and will also depend on your assessment of risk in the circumstances.

This is not a tick-box or cursory exercise and ongoing monitoring of risk is required throughout the duration of transactions. Practices need to make sure they undertake checks at the right points during the transaction – a common problem is that they leave it too late to ask about how the purchase will be funded.

By doing so near to exchange, for example, practitioners put themselves under unnecessary time pressure and as a result, in some cases we have seen, accept substandard/insufficient documentation or just fail to undertake checks properly.

We have practices that highlight the need for documentation on these issues in their terms and conditions, along with a warning that they may not be able to complete the transaction to the clients' timetable. This is a sign of a good AML culture.

The use of checklists and other documents, such as purchase questionnaires, can also ensure that the practice is working consistently and has the necessary information at an early stage in the process and that any follow-up work is recorded and undertaken in a timely manner. The CLC has drafted a Source of Funds Checklist and Guidance which advises on the importance of verification as early as possible and highlights common issues. Practices must also ensure that their AML policies and procedures capture source of funds and source of wealth – we have a template AML policy which practices are free to use.

We will also publish an advisory note later this year setting out the CLC's position on requesting source of funds and source of wealth. The CLC takes the approach that the higher risk associated with conveyancing means that practices must undertake source of funds checks on every transaction, although the extent to which they do so will be dictated by the risk arising in every case.

Risk assessments

CLC practices are required to have a practice-wide risk assessment (PWRA), as well as risk assessments for all clients and most matters. We expect PWRAs to be reviewed annually – which is often not happening – or when there is a significant development, such as new legislation or a change to the business.

A poor PWRA is often emblematic of a poor AML culture at a practice. If you are not identifying the risks, how can you discharge your AML obligations? An analysis of practice inspections in 2022 found inadequate PWRAs present in 68% of practices that had been found to be non-compliant with AML rules.

The LSAG guidance explains that matter and client-based assessments will help you to consider whether you are comfortable acting and, if so, to adjust your internal controls to the appropriate level according to the risk presented.

In limited circumstances, it may not be necessary to conduct an assessment on every matter, such as when the matters undertaken for a particular client are highly repetitive in nature, with risk remaining consistent and addressed in detail in the client risk assessment. However, it is important to ensure that ongoing monitoring of the client relationship occurs at regular intervals, including to redo client due diligence on existing clients at certain intervals.

However, we find that conveyancers are often not undertaking assessments because they do not perceive a transaction to be risky. In the conveyancing sector, this is not good enough – you must show you have considered the risk and then use that assessment to decide what level of client due diligence you will undertake.

Also, it is not a one-time assessment – as a matter evolves, it may be necessary to revisit and adjust the assessment. Our Template Client and Matter Risk Assessments recommend that the matter-based assessment should be completed not only at the beginning of a transaction but also during the transaction and just before the transaction has exchanged.

The CLC is concerned that matter-based risk assessments are too often not being done or are not comprehensive enough. We are now looking to move to disciplinary action for practices where we have identified a pattern of failure.

Digital ID checks

In March 2022, Lawtech UK and the Regulatory Response Unit – of which the CLC is a member – issued a joint statement to correct misconceptions among lawyers about whether they can and should use digital ID verification systems.

The joint statement confirms that legal services regulation does not prohibit the use of digital ID verification tools in any of the jurisdictions of the UK and in fact the government is working to encourage and unify ID verification across sectors, for the benefit of the public and professionals.

When used correctly, digital ID verification can provide a fast, cost-effective and reliable way to verify an individual's identity and reduce money laundering and compliance risks. It can make it easier to spot fake documents, for example, make the client onboarding process faster and smoother, and support the legal community to keep pace with changes in international economic sanctions.

HM Land Registry offers a 'safe harbour' to conveyancers using a digital identity method that complies with its digital ID standard, meaning it will not seek recourse against them, even if their client was not who they claimed to be.

Cryptocurrencies

Questions about payment by cryptocurrencies such as Bitcoin are becoming more frequent. Below we lay out issues that practices should consider. The primary stumbling block, however, is that professional indemnity insurers may not be willing to extend cover to transactions where a cryptocurrency is used. Until this changes, source of funds issues may be academic.

This means the first step a practice should take is to check with their insurer about whether they can proceed with such a transaction. Insurers may have additional requirements regarding high-risk transactions, so you should take steps to understand your insurer's attitudes to accepting transactions which are funded by crytptoassets.

You should also consider whether you have the expertise and skills to handle this type of work or if it is outside the usual remit of the business, which is likely to increase the risk to the practice.

Since January 2020, the Financial Conduct Authority (FCA) has supervised how cryptoassets businesses manage the risk of money laundering and counter-terrorist financing – they must comply with the Money Laundering Regulations (MLRs) and register with the authority. The FCA maintains a register of compliant cryptoasset providers, as well as a list of the unregulated businesses it is aware are operating in the UK.

So although such transactions should normally be considered as high risk, this means the risk may be mitigated depending on the type of cryptoassets or trade platform used, and whether it is regulated.

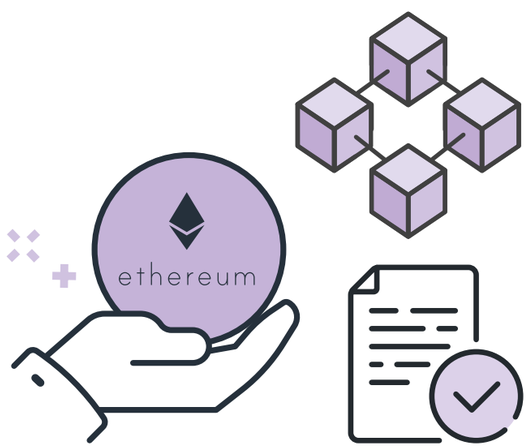
Ultimately, the same principles apply to identifying source of funds and wealth irrespective of where funds originate from. But currently we consider the AML approach to transactions funded by cryptoassets to be similar to that of cash purchases.

We would therefore expect practices to complete enhanced due diligence due to the high-risk nature of the transaction. Practices should take adequate measures to establish the source of funds and source of wealth. The evidence required to verify the source of wealth should be considered on a case-by-case basis, as what is sufficient in one case may not be sufficient in another. It is important that as much information as necessary is obtained in order to trace the funds and be satisfied that they are legitimate.

Due diligence may include obtaining statements and trade histories and considering whether this information is sufficient to establish the legitimacy of the original funds or whether the investment has generated the funds to be used in the transaction. A few things to consider are:

- Were the funds originally deposited in the bank account/crypto-wallet consistent within the lifestyle and economic means of the client?
- Can the client explain, verify and provide evidence for any unusual activity or transactions?
- Do you have enough information to be satisfied that the funds are legitimate?
- Does the name and address contained on the bank statement/crypto-wallet correspond with the information provided by the client?

Please also bear in mind that if you cannot complete client due diligence, then you should terminate the business relationship under the 2017 AML Regulations.



Sanctions

In the wake of Russia's invasion of Ukraine and the government's continuing work to target those linked to the Russian regime, practices' awareness of and compliance with sanctions is a very high priority for the CLC.

Information about the UK sanctions regimes is regularly updated and published online by the government. This includes both individuals and entities in a regularly updated UK Sanctions List. While it can be a challenge to keep on top of the changes to the list, it is imperative that practices do so. They should also keep abreast of changes to the list of high-risk third countries and also to the scope and extent of sanctions, such as the recent expansion regarding trust services.

There are various online providers that can help with this, but practices should ensure they use a recognised provider that updates the latest risks and responds to new rules and regulations. If a practice is using manual checks for sanctions, they should consider using the Office of Financial Sanctions Implementation (OFSI) search tool, which is comprehensive and covers partial matches and even misspellings.

Practices should also consider whether a client is acting as an agent or proxy for a sanctioned person. It is imperative that beneficial owners of companies are identified appropriately and corporate structures properly understood.

Remember that sanctions do not just apply to Russia and Belarus – the sanctions regime has a global reach and applies to multiple nationalities and organisations.

Fees/Exemptions

Some exemptions may be possible under the Office of Financial Sanctions Implementation, which will decide if fees for some work are permissible. The rules on the above may also change rapidly and should be carefully checked in all relevant transactions.

Your responsibilities

Failing to follow the financial sanctions requirements could result in disciplinary action, criminal prosecution or a large public fine. You should ensure that you have the right processes, systems and controls in place now – and in future – to comply with any sanctions developments.

For more information, read the CLC's Sanctions Advisory Note.

Register of Overseas Entities

The Register of Overseas Entities came into force on 1 August 2022 through the Economic Crime (Transparency and Enforcement) Act 2022. Held by Companies House, it requires overseas entities that own land or property in the UK to declare their beneficial owners and/or managing officers.

This increases the obligations and risk when acting for an overseas entity or a client purchasing from one; breach of the Act can be a criminal offence and failing to understand the obligations also increases the risk of a negligence claim.

To register a property at HM Land Registry, the entity will need an overseas entity identification number, issued by Companies House. The number will also be needed for certain forms, such as transfers and leases.

To register with Companies House, the managing officers and/or beneficial owners need to have their identities confirmed by a UK-regulated agent. A list of them can be found here.

Fractional developments are proving a major red-flag to insurers

Compliance with the Accounts Code

Compliance with the CLC Accounts Code is, of course, a core obligation. But experience tells us that accounts-related misconduct increases during periods of economic instability and so we are putting a greater focus on this in 2023.

Too often, we come across unreconciled items and aged balances. Typically practices undertake reconciliations on the last day of the month – we require they be done on a monthly basis as a minimum, with larger practices reconciling every week or even every day. Practices must ensure appropriate oversight on signing off reconciliations – either the HOFA (if an ABS) or authorised person (if not).

Aged balances

These come up in virtually every inspection we carry out. Put simply, if money you are holding is not moved for 12 months and you do not have reason to keep it, it becomes an 'aged balance' and you need to pay it to the rightful recipient. The longer you wait, the harder it will be to track down the rightful recipient, often the client.

CLC practices can self-certify – without needing our permission – that any balances not exceeding £50 should be transferred to the office account, paid to a charity or to the CLC's Compensation Fund. Practices still must report to us what steps they have taken to try to pay the balances to the rightful recipient and seek permission where the balance exceeds £50.

We issued Guidance on Aged Balances to compliment the Accounts Code.

Rather than deal with aged balances, best practice is to stop them arising in the first place. Practices should consider implementing a policy that a file cannot be closed and archived until residual balances (not including retentions or other funds validly retained) have been resolved.

Suspense accounts

Related to this is the issue of suspense accounts, which we are finding with increasing regularity. Their use must be avoided as the money sitting in them can otherwise be forgotten about – as it disappears from bank reconciliations once on a ledger – and it becomes harder to trace the origin of the money as time goes on.

Not allowing the use of suspense ledgers will ensure that you and your staff investigate the source of the funds and appropriately post the funds to a client ledger promptly.

Disciplinary case studies

Two Adjudication Panel decisions in the last year concerned Accounts Code failures.

In one, the practice moved substantial sums of money from the client account to the office account to cover office expenses. These sums of money were not linked to any particular matter or transaction. The practice made full admissions to this conduct during the disciplinary hearing.

As well as reprimands and fines for the practice and its two principals (there were other unrelated allegations admitted too), the practice had to expend a considerable amount of time and money in rectifying the problems with its accounts.

In the other case, the licensed conveyancer admitted to conducting work beyond the scope of her practice's authorisation – probate and estate administration – and on three occasions allowed the client account to be used when there was not an underlying transaction. One related to her own mother's estate, the second to another estate, and the third to the practitioner assisting a local family in cashing in a bond. This last matter also breached the rule against using client account as a banking facility.

The misconduct was aggravated by the fact that the CLC had previously identified similar issues at a prior inspection. Even though inspection actions had been produced to remedy the issues, the licensed conveyancer carried on regardless.

In reprimanding and fining the licensed conveyancer (there was another admitted allegation around conflicts of interest as well), the panel found that the practitioner had become "complacent, and allowed convenience and habit to inform her practice, cutting corners and disregarding the clear requirements and duties set out in the Code of Conduct and the accompanying CLC codes".

We have seen examples in the last year of unauthorised individuals with inadequate supervision handling transactions

Conflicts of interest

The Conflicts of Interest Code provides that CLC-regulated practices can act for more than one party to a transaction with informed written consent.

It specifies that, in such a situation, each party must at all times be represented by different authorised person(s)/parties conducting themselves in the matter as though they were members of different entities.

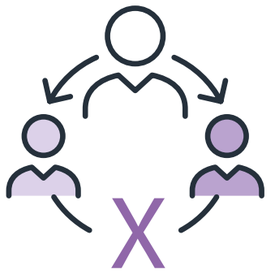
What are the risks?

There is a heightened risk of conflict of interest in such situations and so there need to be people of an appropriate level of seniority handling the matters to ensure they recognise any conflict that may arise.

However, we have seen examples of unauthorised individuals with inadequate supervision handling such transactions. This is not acceptable. If the nature of a practice's structure means it cannot meet the requirements for acting for both sides in a transaction, then they must not take on the second client.

To be clear, while the fee-earner handling the matter does not have to be authorised in these circumstances, their direct supervisor is required to be. In May 2023, the CLC issued new Acting on Both Sides Guidance, which expands on this issue.

Practices also need to ensure there is adequate separation between the fee-earners and authorised persons acting for the different parties. At a minimum, this means they should not be able to overhear each other's conversations – we have seen cases of them sitting next to each other – and ideally, they should be in separate rooms or even offices.



We are aware that some practices will only act in these circumstances if they can act for each party from different offices. Additionally, best practice is to ensure that case management systems have controls in place which prevent individuals accessing the other side's file.

An issue for practices to consider is whether the authorised persons involved in such matters also hold compliance roles that may conflict or lead to information leaking out.

In one recent disciplinary matter, the practice's HOLP and HOFA/MLRO acted on either side of a transaction. This created a foreseeable risk if the HOLP needed to escalate a money laundering issue to the MLRO, which would undermine the information barrier that was between them.

The practice's view was that, in such a situation, the MLRO would cease to act, and a different authorised person would take over conduct of one side of the transaction. The Adjudication Panel disagreed, saying that the practice would have to cease to act altogether. It also considered that there was a clear and significant risk of conflict arising in circumstances where the MLRO acts on one side of a transaction, and that acting in such circumstances demonstrated a lack of integrity.

As mentioned earlier, the CLC has recently refreshed the guidance in this critical area, primarily to outline the scenarios in which acting on both sides is permitted.

This will assist practices in achieving compliance with the Conflicts of Interest Code and will be a useful tool when devising policies and procedures in this area.

Disciplinary case study

Last year, the Adjudication Panel found that a licensed conveyancer failed to inform clients in three matters that she had been asked to act for another client in the transaction. She said she had informed them verbally but could provide no evidence of this. There was no written consent.

The decision said: "The panel considered that informing a client that you were acting for both parties in a transaction was extremely important information, which should have been recorded in writing and the potential implications for each client made clear."

Further, the authorised person was the sole conveyancer in the practice, meaning she would personally be undertaking the work on both transactions. She believed she was acting in both clients' interests by doing so as the transactions would proceed more quickly.

But she acknowledged with hindsight that she was not in fact acting in either client's best interests, particularly if a potential conflict had arisen in relation to the transactions. The panel found there was "no way" in which the potential conflict could be surmounted in such a situation.

The practitioner's misconduct was aggravated by the fact that the CLC had previously warned her about not acting on both sides, which she had acknowledged, but later continued to do it. This amounted to a lack of integrity, the panel found.

The licensed conveyancer admitted to other, unrelated breaches as well and was reprimanded and fined.

Complaints handling

On 1 April 2023, the Legal Ombudsman (LeO) changed aspects of its scheme rules, which will have a significant impact on complaints.

The main change is that the time limits for referring a complaint to LeO are no later than:

- One year from the date of the act or omission being complained about; or
- One year from the date when the complainant should have realised that there was cause for complaint.

At the same time, LeO has lowered the level of discretion to accept out-of-time complaints, from "exceptional circumstances" to where it is "fair and reasonable" to do so.

The rule that complainants must make their complaint to LeO within six months of the date of the final complaint response is unchanged.

Other significant amendments include a new discretion to consider a complaint resolved on the basis of an investigator's case decision if neither party provides any substantive reasons for disagreeing with it, and extending the circumstances under which LeO can exercise discretion to dismiss or discontinue a case.

These include where the ombudsman is satisfied that the complainant has not suffered 'significant' loss, distress, inconvenience or detriment; or where the size or complexity of the complaint, or the behaviour of the complainant, results in the complaint requiring a disproportionate use of resources.

More details about the changes, as well as suggested new wording for your client-care letters and complaints procedures, can be found on the LeO website here, along with some FAQs.

Complaints handling is important in and of itself but practitioners need to remember that it also impacts on the cost of regulation. The cost of LeO is passed on to all the approved regulators through a levy based on the average number of complaints generated by their communities over the previous three years.

CLC-regulated practices generated 327 cases for the 2022-23 period (2021-22 - 256 cases). The figures are based on OLC calculations of a three-year rolling average. The 2022-23 figure represents just 6% (2021-22, 4%) of the total cases handled by LeO – but the costs of the OLC are a very significant cost of regulation. In 2022-23, the OLC cost the CLC regulated community £864,046, an increase of 26% on the previous period and equivalent to roughly one-third of the CLC's costs of delivery regulation. This is despite the fact that 58% of practices have not had any cases accepted by LeO in the three-year cycle ended in March 2023.

In 2021, we separated the OLC cost from the CLC operating costs which are collected through the practice fee and introduced a new charge called the OLC levy (the Office for Legal Complaints, the formal name for LeO). This meets the costs of the OLC that are apportioned to CLC-regulated practices. Under it, 70% of this cost is collected proportionately from all regulated practices and the remaining 30% is collected from practices that have had cases accepted for investigation by LeO.

We expect that this will incentivise firms and individuals to deal with complaints in a more timely and effective manner

It is fair that all practices still pay something towards the cost of LeO as there is a profession-wide benefit to its availability in terms of consumer protection. Some 93 practices (prior year 83) had cases accepted by LeO in 2022-23 and were allocated a portion of the total cost on the basis of a case fee. We had previously anticipated that the usage element of the cost would be increased over time from 30% to 80% but we have noted that the number of cases accepted by LeO for investigation in 2022 reduced significantly. In light of this change, we will not be increasing the usage element of the charge as the case fee would become very disproportionate.

The rationale for introducing the levy was to:

- Draw attention to complaint handling and incentivise better complaint handling;
- Allocate some of the cost based on the drivers of the cost (cases investigated);
- Increase transparency by highlighting the cost of LeO vs direct regulatory cost; and
- Ring fence the CLC operating budget which was being squeezed by disproportionate increases in LeO cost.

The CLC will continue to actively monitor complaint handling and focus specifically on practices with a disproportionately high number of cases being referred to the ombudsman.

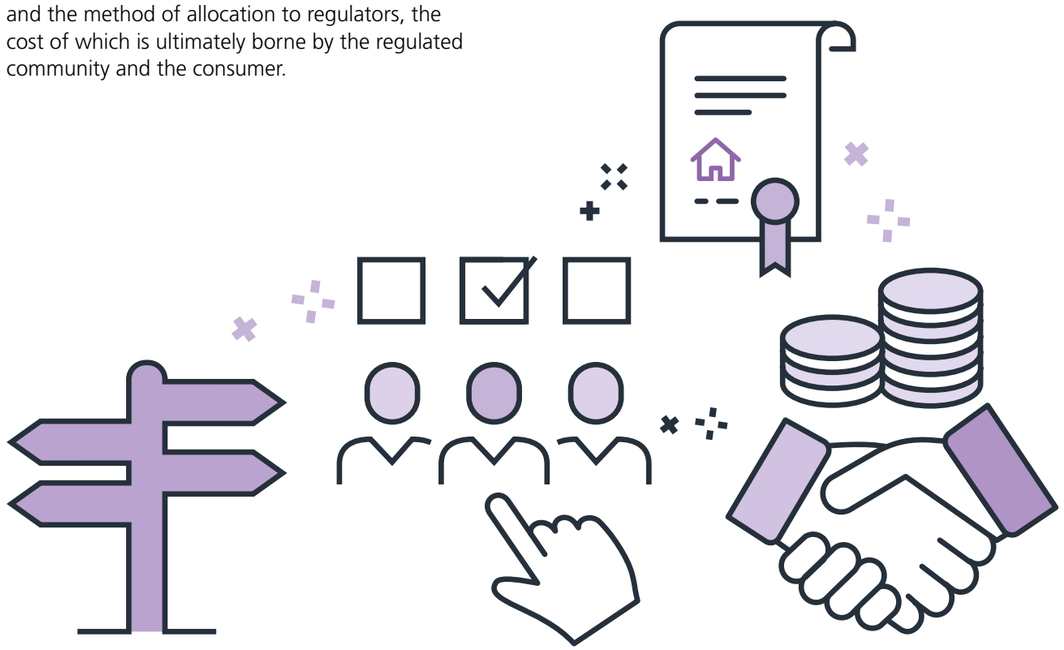
We remain concerned by the high cost of LeO and the method of allocation to regulators, the cost of which is ultimately borne by the regulated community and the consumer.

Disciplinary case study

A practice and its two principals were sanctioned for failing to respond in nine cases to LeO's requests for information within the deadline, failing to carry out LeO's direction in four cases, and failing to respond to two complaints from clients within the required timescale.

The practice brought in an external law practice, at considerable expense, to audit its complaints process and make recommendations for improvements. Nonetheless, LeO continued to make referrals to the CLC because the practice had not co-operated as required in a timely fashion to its investigation into new complaints, while the practice continued to receive a large number of complaints.

The Adjudication Panel said: "The panel takes particularly seriously any case where a licensed conveyancer or CLC-regulated practice fails to co-operate appropriately with the CLC itself, as well as the LeO, as without proper regulation the reputation of the profession, and the public confidence in licensed conveyancers, could be significantly undermined."



Breach of undertakings

The CLC has received too many complaints about practices it regulates breaching undertakings. This is of significant concern; the property transfer system will break if conveyancers do not adhere to undertakings.

Our Undertakings Guidance explains that, while neither the CLC nor its disciplinary committees has power to direct the specific performance of an undertaking or to direct the payment of compensation to a third party, the breach of an undertaking may lead to disciplinary proceedings.

While we understand that sometimes an individual breach is due to the action/inaction of a third party – such as a lender or management company – the CLC is escalating its activity on this issue and tracking practices where we are seeing repeated or systemic breaches. Problems can emerge from practices not having proper processes in place post-completion or even to provide undertakings in the first place.

Practices should also have considered the impact of the Supreme Court's 2021 ruling that undertakings provided by law practices that were limited liability partnerships or limited companies were not enforceable by the court. Though the court said Parliament should extend its jurisdiction to cover incorporated practices, this has yet to happen.

Some firms are doing the minimum possible and not operating within the spirit of the rules

Best practice is to ensure the files are scanned or exported to PDF and saved in an electronic database at the point of archiving

IT resilience and recovery

Businesses of all sizes now suffer cyber incidents and law practices are no different. Readers will be aware of one very high-profile incident in the CLC community in the last couple of years which should act as a warning to be ready for when it happens to you. Because it will – it is a matter of when, not if.

One key message from that incident is that practices need to understand just how dangerous and disruptive an attack can be – it's not just the incident itself but the recovery from it that has the potential to heavily disrupt client work and suck up huge amounts of management time, money and energy.

Preparing for an incident

For these purposes, we expect that practices are keeping on top of their IT security. A cautionary tale came out in early 2022, when the Information Commissioner's Office fined a large solicitors' practice £98,000 for failures that opened the way to a ransomware attack. The practice knew it had problems with cyber-security the previous year, having failed the government-backed Cyber Essentials standard, but did not rectify the known issues quickly enough. Further, there was a known system vulnerability for which a patch was released but only applied by the practice five months later.

Your IT department/supplier should be continually monitoring the range of data protection options, and counter-measures, available. Microsoft, for example, offers new counter-measures every fortnight.

Systems are ever more integrated nowadays, but the risk and impact of a cyber incident can be effectively reduced by segmenting, rather than separating, systems. This means they are restricted to talking to each other in very defined and limited ways and allows them to be isolated if needed. You should deploy an endpoint detection response tool to spot an incident, which will quarantine any device which has this problem detected.

People can be both your greatest strength and your greatest weakness. You need to keep on top of awareness among staff and clients and have regular testing in place to see if your systems can be penetrated in different ways.

We have identified five issues to consider in preparing for an incident:

- Ensure you have an internal incident response team with representatives from at least operations, IT and communications. Rehearse and simulate to test readiness to deal with issues in a live environment. Mapping out your digital processes will be useful as part of this and may allow you to adopt offline processes for a time if required. Also, maintain a separate list of customers so you can contact them if core systems are down.
- Select specialist vendors of key services ahead of time: legal, IT forensic and public relations (it may be your cyber-insurer has a panel of these). Engaging external legal advice gives you the benefit of privilege, which you can later waive, as necessary.
- Have appropriate cyber-insurance arrangements and really understand the scope and scale of cover. Business interruption and response cover are vital too.
- Carry out a mapping exercise to understand your regulatory obligations, such as reporting requirements to the CLC and clients.
- Are you prepared to pay a ransom? If so, in what circumstances and are there any barriers to doing so?

Ongoing risks

We have flagged up various issues in previous editions of the Risk Agenda which are ongoing issues for practices to consider but for which we do not have new information to add this year.

The Risk Agendas from last year can be found here but these are the issues you should be aware of:

Buyer-funded developments

Buyer-funded developments, also known as fractional developments, continue to be a major red-flag to insurers. They involve the use of individual deposits of as much as 80% to fund the purchase and build of the development, instead of the developer sourcing commercial finance. They are unlike traditional deposits put down on new-build developments, where the conventional 10% is held in an escrow account, because they place significant capital at risk.

These schemes come in many forms – from car park spaces and storage pods to holiday apartments, hotels, and student accommodation – and are often for investment purposes, as the owner is attracted by the opportunity to rent out what they buy.

However, there have been multiple examples of the developers failing and the deposit money being lost – in some cases, the whole scheme was a scam to defraud the investors of their deposit money. Conveyancers have been used to provide a veneer of respectability and can find themselves on the receiving end of claims in the event of a development's failure.

The conveyancer must undertake a high level of due diligence before becoming involved in any scheme of this nature. You should also check how you are being described in any marketing material.

Transparency and informed choice

The sector-wide requirements to provide certain information to help consumers make their choice of lawyer apply to all CLC lawyers. There is a strong interest in this issue from those overseeing the sector.

The CLC has published an Informed Choice Toolkit – which includes templates to display information – and has been actively monitoring practices' compliance.

CLC practices can decide the best way to display cost information, but some practices are doing the minimum possible and not operating within the spirit of the rules, for example by not having the information in a prominent and accessible place (generally, it should be available with one click from the homepage) or listing overly broad pricing ("Our fees start from £700"), which is not transparent and does not explain the basis on which the fee is calculated or whether it includes disbursements and VAT.

A reminder too to ensure that the CLC Secure Badge is in a prominent place on the website, and that practices must include their licence number on all communications. The CLC secure badge is a valuable tool for clients to protect themselves from scams that helps protect your practice, too.

The CLC wants to know that you have considered the risks and are prepared for possible scenarios, including rapid closure

Best practice is to ensure the files are scanned or exported to PDF and saved in an electronic database at the point of archiving

File storage

We frequently receive questions asking how long practices should store files for. You should not keep them for longer than you need for data protection reasons – this includes data stored electronically.

Under the Transaction Files Code, CLC practices must retain the contents of files relating to all matters for a minimum of six years, except those relating to:

- other conveyancing matters (other than the sale of property) for a minimum of 15 years (for example, purchase conveyancing files);
- wills for a minimum of six years after the testator has died; and
- probate matters for a minimum of six years from the end of the executor's year.

Consideration should be given on a case-by-case basis as to the appropriate date of destruction for the contents of files relating to deeds of gift, gifts of land, transfers at an undervalue, right to buy where funds came from someone other than the purchasing tenant(s), and lifetime gifts, as it may be prudent to retain files for longer than the minimum 15 years.

Our Transaction Files Guidance notes that, due to increasingly diverse relationships and family structures, people living longer, and growing challenges/disputes regarding testators' wishes, practitioners may wish to consider retaining will documentation for much longer.

Should a practice decide to store files electronically, you must review paper files to ensure that you do not destroy original paper documents where they are required to have legal effect (such as wills and deeds), or where questions about the authenticity of the document may in some instances only be determined on production of the original.

In the case of aborted matters, retaining files is in the practice's discretion, but note that any data held must comply with the practice's obligations under AML regulations, i.e. it must be held for five years from the date of the last active matter's file closure.

File storage is also a key part of an orderly shutdown – the regulatory obligations to retain archived files do not cease at that point. The CLC lawyer must plan for files' ongoing retention.

Disciplinary case study

A practice passed on all of its active files to another practice but abandoned 15,000 archived files at offices where the rent was not being paid, despite the CLC giving the practice clear guidance ahead of its closing, that arrangements would have to be made for the files. The CLC had no option but to intervene in the practice to secure these files.

The Adjudication Panel found this failure to act in clients' best interests to be serious misconduct and contributed to the decision to disqualify the owner for a year.

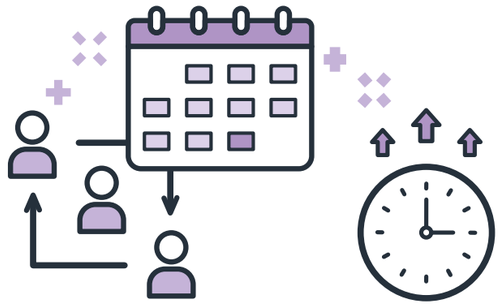
Where appropriate, the CLC will apply for the defaulting lawyer to pay the costs it incurs in arranging file storage and in connection with adjudication of the matter.

Business continuity planning

All CLC practices should have in place their own business continuity plans (BCP) for ensuring the continuing delivery of services to clients. It should cover a wide range of circumstances where services may be disrupted – it is more than just saying what you will do if the office burns down.

The BCP has become increasingly important for all businesses following the pandemic. Practices need to think about how they operate and what their risks are (indeed, do you have your own risk register?). Does the BCP address the risks identified? Do not just pull a BCP off the shelf – the plan must reflect your operations and the resources you have. You need to hold the pen on it because ultimately the CLC will hold the practice's managers responsible.

Existing practices need to review their plan at least once a year – it should be a live document that represents how your business operates at that time.



Closing your practice

The pandemic followed by a worsening economy has led to a number of CLC practices closing down or merging. The CLC expects this to be done in an orderly fashion, with post completion work attended to in a timely manner, to ensure clients' interests are protected, but this is not always happening.

Other sections of the Risk Agenda – on, file storage and business continuity plans – are relevant to this too.

The process for surrendering your CLC licence is outlined on the CLC website, including a Sample Exit Plan detailing what needs to be done. We would generally expect to receive a minimum of six weeks' notice from a practice that is shutting down, at which point it should not take on any new work.

Rapid closure can generate extra risks, including completing transactions and returning client money.

An effective business continuity plan will contain the delegations needed to close down a practice in certain circumstances, such as the death of an owner.

Disciplinary case study

Authorised persons should notify us if their practice is at risk of financial distress. In one disciplinary case, both the law practice owner and a non-shareholding director were sanctioned for not considering the risk of financial distress; they only considered they had a duty to report when the state of financial distress had been reached. The risk of financial distress must be considered in order to assess whether that risk is significant.

There were multiple indicators, such as the practice's accountants warning that the practice was unlikely to survive unless there were major changes, a discussion about redundancies, an inability to pay rent and bills, including of the practice's accountants.

For confirmation of the range of circumstances about which the CLC expects practices to notify, please refer to the Notifications Code.

Contact us
For enquiries, please use the details below.

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