CLC Regulating Property And Probate Lawyers

Council for Licensed Conveyancers

Risk Agenda

www.clc-uk.org

Welcome to the first Risk Agenda produced by the Council for Licensed Conveyancers.

We regulate a profession that constantly demonstrates very high levels of compliance. We should all be proud of the effort that goes into ensuring that the public has full trust in licensed conveyancers and probate practitioners regulated by the CLC. This reputation is hard won and, of course, easily lost.

We believe in being available to, and working constructively with, our regulated community, rather than you only hearing from us when something has gone wrong. This approach ensures you are able to do the best job you can – and that is good for clients, for practices and is good and effective regulation.

Naturally, nothing is perfect, and the purpose of this Risk Agenda is to highlight issues that our staff have encountered during their monitoring and inspection work, from those that affect every practice – such as anti-money laundering – to those that become problematic for a relative few, like storing files after closure.

Importantly, none of the issues identified here are widespread or systemic but even isolated failures can have a significant impact on perceptions of the profession and stakeholders' approach to dealing with CLC-regulated practices. Running a legal practice involves juggling many balls and this document may help you identify one or two that have inadvertently fallen by the wayside.

We intend to update the Risk Agenda on an annual basis. If you have any concerns as a result of what you have read, do not hesitate to speak to your Regulatory Supervision Manager for advice.

Sheila Kumar
Chief Executive

Hundreds of millions are laundered through conveyancing across the UK

Anti-money laundering

Everyone in our regulated community will be aware of the high priority both we and the government place on anti-money laundering.

The National Risk Assessment of Money Laundering and Terrorist Financing 2020, published in December by HM Treasury and the Home Office, said conveyancing remained a high-risk area for money laundering. It was "likely that thousands of properties in London have been bought with illicit funds over the years", the assessment said, and "hundreds of millions are laundered through conveyancing across the UK". This underlines the importance of submitting Suspicious Activity Reports event if you do not always hear back about them.

Your duties are laid out in the Anti-Money Laundering (AML) and Combatting Terrorist Financing Code and the Money Laundering Regulations 2017 (as amended). We stress that, if you have concerns about a transaction or cannot satisfy yourself on questions of identity or source of wealth it is probably not worth taking the risk of proceeding.

We are highlighting three specific issues that we have encountered.

Source of funds and wealth

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.

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 provided with. For example, does their income and wealth correlate with their job role? Information should be verified with evidence, rather than simply taking clients' assertions. 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.

CLC lawyers need also to consider their own position. We have dealt with a case of a CLC lawyer working for a practice regulated by another regulator who was not happy with the evidence a client had supplied as to their source of wealth, even though the practice was. The CLC lawyer approached us for advice. We explained what we expected of her, as a result of which she escalated the matter to the practice's money laundering reporting officer. They still did not act as she expected, and as a result the intelligence was passed to the practice's regulator. The CLC lawyer did all she could in the circumstances to meet AML requirements and her responsibilities as a regulated individual.

Identification and verification

The Covid-19 pandemic has raised questions about undertaking due diligence checks when you cannot meet the client in person and view physical identity documents. Practices have been asking for approval of their approaches.

The obligations remain constant, notwithstanding Covid-19, and practices are not required to conduct enhanced due diligence simply because they have not met clients face to face. But you must take every possible step to ensure that the person on the other end of the telephone or video call is who they say they are and if electronic searches are undertaken, you must ensure that the search provider is secure from fraud and misuse.

We have produced a guidance note and webinar on using digital identification and verification methods that provide practices with assistance in confirming that a client is who they claim to be. Using such systems can be a significant improvement on reliance on paper or certified copies of ID documents and help you reduce your risks.

Fifth Money Laundering Directive

This directive came into force on 10 January 2020 via the Money Laundering and Terrorist Financing (Amendment) Regulations 2019. The key changes are highlighted in this guide from the Legal Sector Affinity Group, of which the CLC is part.

Our work to date shows that a lot of practices are already in compliance. However, a number have not updated their policies, controls, and procedures (PCPs) to reflect the changes. Up-to-date PCPs are a requirement of the Money Laundering Regulations and the CLC would expect all practices to be fully compliant now that a year has passed since the directive came into effect.

There are plenty of resources for the regulated community in our Anti-Money Laundering Toolkit, including updated guidance from the Legal Sector Affinity Group.

Note: The Sixth Money Laundering Directive (6MLD) will have no implications for CLC practices. The UK Government has not transposed 6MLD as UK domestic law already covers its requirements.

Aged balances

A CLC practice needs to take active steps to ensure all client monies are properly paid to the rightful recipient at the conclusion of a matter. After 12 months, any monies remaining on the client ledger are treated as ‘aged balances’.

Unfortunately, our inspections show that many practices have aged balances on their books, and the amounts involved can quickly add up. We have seen practices with tens of thousands of pounds of aged balances. Without the right processes in place, these balances can be easily overlooked once a transaction is completed – one practice we saw recently had aged balances dating back eight years.

Under changes to the Accounts Code that came into force on 30 September 2020, CLC practices can determine – without needing our permission – whether 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 return balances to clients and seek permission where the balance exceeds £50.

We issued new 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.

Where practices do have residual balances, they should ensure they are reviewed on a regular basis and not left simply to age and accumulate.

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 appropriate level of seniority handling the matters to ensure they recognise any conflict that may arise.

However, we have seen examples in the last year 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.

Practices also need to ensure there is adequate separation between the 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.

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

The CLC has published an Informed Choice Toolkit

Transparency and Informed Choice

There are sector-wide requirements to provide certain information to help consumers make their choice of lawyer to that apply to all CLC practices lawyers. There is a strong interest in this issue from those overseeing the sector, such as the Legal Services Board, the Legal Services Consumer Panel and Competition & Markets Authority. The government is also monitoring progress.

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

What are the risks?

CLC practices can decide the best way to display cost information, but we have found that some practices are doing the minimum possible and not operating within the spirit of the rules.

The information needs to be in a prominent place and be accessible. Generally, it should be available with one click from the homepage.

Broad example pricing, such as "Our fees range from £300 to £2,500" or "Our costs start from £700", is not transparent and does not explain the basis on which the fee is calculated or whether it includes disbursements and VAT.

Quote generators are popular and a good way of providing tailored information, but practices should not require users to enter contact information before receiving a quote. They should be clear that it is optional. An alternative is to show examples of quotes for a range of property types as well so that users have a clear idea of what their quote is likely to be.

The CLC Secure Badge should be displayed 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.

There are practices that do not have websites, they are however not exempt from these requirements. They must be able to provide the same information in a short document by email, post or in person if requested.

Professional indemnity insurance

In the most recent insurance renewal round, insurers refused cover to a small number of practices because of the type of work they were conducting.

This highlights three issues:

- Understanding the type of transactions deterring insurers;
- The implications of practices having little time to organise their closure if they cannot secure cover; and
- Delays in insurers providing quotes, with particular issues for new practices and SRA-regulated practices switching to CLC regulation or hiving off their conveyancing departments into a new CLC practice.

Buyer-funded developments and investment schemes

Buyer-funded developments, also known as fractional developments, are proving 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.

Fractional developments are proving a major red-flag to insurers

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. In some cases 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.

Red flags to watch for include:

- High deposits before exchange and high commissions from them for the seller;
- High and/or guaranteed returns of either capital or rental income;
- Complex and/or unfair terms;
- Little or no underlying legal work; and
- Buyers mostly based overseas and/or not having separate representation.

What we expect of you

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.

Overriding Principle 1 requires you to act with independence and integrity, and that you do not take unfair advantage of any person, whether or not they are a client.

Overriding Principle 2 requires you to maintain high standards of work, and that you systematically identify and mitigate risks to the business and to clients.

If you have any doubts at all about the legitimacy of a scheme, it is probably better not to get involved and to focus on less risky work.

New-build developments

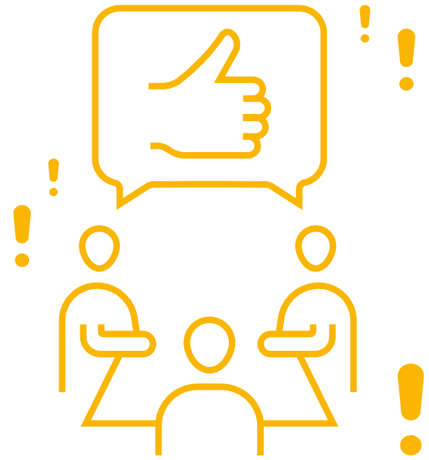
A recent report by a broker to SRA practices says that traditional new-build development work is an ongoing concern for insurers as there have been several large losses experienced through repetition of a single error across multiple units within a development.

What we expect of you

Overriding Principle 1 requires you to ensure clients receive good-quality, independent information, representation, and advice.

Overriding Principle 2 requires you to maintain high standards of work. Within this, the code requires you to ensure all individuals within the entity are competent to do their work and to supervise and regularly check the quality of work in client matters. This code also requires you to keep your skills and legal knowledge up-to-date.

Additionally, **Overriding Principle 3** requires you to act in the best interests of your clients, and within that the code says that you should only accept instructions and act in relation to matters which are within your professional competence.



Break clauses

Break clauses in leases have also been identified as problematic for insurers. One broker said: "Claims frequently arise from the miscalculation of the date for service of a notice, drafting errors and advice provided to clients on the terms to allow the break to be effectively exercised.

"We anticipate the commercial property sector is likely to be heavily impacted by the pandemic and therefore a source of claims. In particular, claims arising from lease drafting and break clauses are likely to become more prevalent. Businesses are now reviewing their property portfolios thoroughly and break clauses will be meticulously studied."

What we expect of you

Overriding Principle 1 requires you to ensure clients receive good-quality, independent information, representation, and advice.

Overriding Principle 2 requires you to ensure clients are provided with a high standard of legal services and client matters are dealt with using care, skill, and diligence. This principle also requires you to supervise and regularly check the quality of work in client matters.

'Dabbling' in private client work

Another issue that causes insurers anxiety is conveyancers who also undertake a small amount of trust and probate work.

What we expect of you

Overriding Principle 3 requires you to act in the best interests of your clients, and within that the code says that you should only accept instructions and act in relation to matters which are within your professional competence.

You must also ensure your CLC Licence allows you to complete this work.

Delays in securing PII quotes

Many CLC practices follow the advice to put their proposals in early to the insurance market, but do not receive a response until late in the day, giving practices little room for manoeuvre.

There are various reasons for this, including market dynamics, and we have engaged with brokers and insurers to discuss how to improve the current situation (and there is more on this on the next page).

New practices/switchers to CLC regulation

Not only has the insurance market hardened over the last year, but there has also been a shift in risk profiling that is affecting new practices and practices switching between regulators. As a result, there have been long delays in obtaining quotes.

We have found that it is important for new practices to speak to every CLC broker to ensure they have a full view of the market – some insurers do not have appetite for certain types of businesses, such as sole practitioners, start-ups or businesses that were previously unregulated. We have also heard some negative feedback around models which involve a significant amount of outsourcing or working with developers. Both insurers and the CLC will want a clear picture of new practices' operating model.

Since the rule change enabling practices to switch from the SRA without having to buy run-off cover, insurers and the CLC want to be sure that avoiding run-off is not the primary reason for the move.

What else can you do?

There are certain elements of good practice that will always give insurers greater confidence in a practice, such as keeping a central diary of activity and deadlines, having a good quality assurance system, and providing relevant ongoing training for staff.

As ever, you should submit proposals to at least two or three brokers as early in the process as you can.

What we are doing

Issues we have raised with brokers and insurers include whether a more comprehensive proposal form could reduce the need for follow-up questions and so delays to issuing quotes, and whether it might be possible to agree service levels for responding to proposals.

Most significantly, perhaps, we are minded to move to a timetable that requires practices to obtain cover in advance of the inception date. This will allow practices that have not been able to secure cover to take the necessary steps to wind up their businesses in an orderly manner and allow the CLC to manage client risk more easily.

Delays in receiving a quote seem even more acute for start-up CLC practices and we are working with brokers on this too.

We will keep our regulated community updated on the progress of these discussions.

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

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:

- Purchases for a minimum of 15 years;
- 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 below the market value, right to buy where funds came from someone other than the purchasing tenant(s), and lifetime gifts.

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

What are the risks?

The CLC is encountering issues around file storage when practices close. The regulatory obligations do not cease at that point, but we find that owners have often not considered this or budgeted for the ongoing cost of storage and or data retention – indeed, they are not always aware that it is their responsibility to arrange and pay for. In some cases, they store their files in an unsuitable location, or walk away from the problem without considering how they would manage their ongoing responsibilities for file retention. This passes the burden of managing the files to the CLC and the cost on to the regulated community.

This is unacceptable. File storage is a key part of an orderly shutdown and the CLC lawyer must address it and plan for its ongoing management.

Some practices are moving to electronic file storage and this can mean different problems if they close.

In many cases, the documents are stored within a case management system (CMS), meaning that ongoing access to the CMS is required – this includes the CLC in the event of intervention. We are also concerned that systems do not have functionality that allows them to export or back-up files.

This has a cost and creates a dependency on the CMS provider when there is a risk of the CMS malfunctioning or the provider ending support for it.

CLC rules require files to be stored on a "durable medium" and we consider that, due to the problems we have encountered, a CMS does not count as such. By contrast, a PDF is a durable medium because it is universally accessible.

From a practical point of view, documents stored in a CMS can be difficult to collate – if a client seeks their files, they must be printed or downloaded one document at a time because the system cannot batch-export them to a PDF.

Best practice is to ensure the files are scanned or exported to PDF and saved in an electronic database at the point of archiving. The CLC is considering whether to mandate that archive files are stored in this way.

We are also investigating whether we might maintain a central database for all files of closed practices stored in this way. This would assist the CLC in more effectively and efficiently protecting consumers.

Business continuity planning

All CLC practices should have in place their own business continuity plans for ensuring the continuing delivery of services to clients. The Covid-19 pandemic and ongoing lockdowns and restrictions have tested these to the full and we recommend that they are reviewed in light of the individual practice's experiences.

An issue we are raising with practices, however, is whether they are prepared for a sudden closure. This could be for a number of reasons, such as difficulties with renewing professional indemnity insurance or the owner being incapacitated (few owners have thought about how their practice would manage without them), as well as longer-term succession in the event of unplanned exits from the business. We have seen that businesses wholly owned by non-lawyers can have a higher turnover of senior legal staff. It may not be easy to have the conversations about these issues, but it is much better to have them in advance rather than having to deal with a crisis in haste.

The CLC wants to know that you have considered the risks and prepared for possible scenarios including rapid closure. In the event of a partnership or limited company, does the partnership agreement/shareholders agreement cover such eventualities? On what terms can an investor take their money back? Do you know whether the licence with your case management system provider includes continued access to files? Who has access to and can operate the practice's bank account in the owner's absence?

We will be issuing more guidance on preparing for practice closure this year.

Contact us
For enquiries, please use the details below.

We are open Mon-Fri, 8am-5pm.

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