Council for Licensed Conveyancers

Risk Agenda

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 moving home or losing a loved-one.

The CLC's unique approach to regulation is to work with practices to identify and address risks before they crystallise as harms to the client or public interest. What we describe as 'assisted compliance' is what we hold to be the most proportionate and effective approach to regulation, and it is successful in resolving the vast majority of incidences of non-compliance that we find. However, some failings will result in disciplinary action either because of actual harms or a refusal on the part of a practice, to work with the CLC to come into compliance.

Today, the threats to your clients' assets are more sophisticated than ever and the challenges for lawyers have grown correspondingly. Property transactions and probate issues are more complex than ever before as family life changes and lawyers have serious responsibilities to help combat fraud and money-laundering as well as ensuring that sanctioned individuals or businesses cannot get around the restrictions that the UK government or international community has placed on them.

The second 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. It is part of the CLC's core mission of maintaining high standards of consumer protection and promoting a thriving legal services sector.

This edition looks at a wide range of issues, from digital identity checks to changes to professional indemnity insurance, complaints handling to cybercrime. I hope that you will find this useful in your practice. We would be very pleased to hear from you about items that you believe should appear in the next edition of the Risk Agenda.

Sheila Kumar
Chief Executive

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 property in 'cleaning' dirty money.

The National Risk Assessment of Money Laundering and Terrorist Financing 2020, published by HM Treasury and the Home Office, said conveyancing remained a high-risk area for money laundering. It was "likely that thousands of properties have been bought with illicit funds over the years", the assessment said, and "hundreds of millions are laundered through conveyancing across the UK".

Your duties are laid out in the Anti-Money Laundering and Combatting Terrorist Financing the Code and the Money Laundering Regulations 2017 (as amended) (MLRs 2007). The key changes that came into effect on January 2020 are highlighted in this guide from the Legal Sector Affinity Group, of which the CLC is part.

We would also encourage you to read the CLC's Annual Anti-money Laundering Report 2021, 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 MLRs 2007 and is a useful resource for practices.

The report shows how, at the start of the reporting period (6 April 2020 – 5 April 2021), 24 CLC-regulated practices were considered high risk, 29 medium risk and 172 low risk.

By the end of it, the number of high-risk practices reduced to seven and medium risk to 27; there were 183 low-risk practices. We inspected 51 firms in the year, of which 47 were required to undertake informal corrective actions, and only two remained non-compliant at the end of the reporting period.

If practices fail to achieve compliance through work with the CLC, they may face disciplinary action.

These were the common areas of non-compliance:

60% of practices could not provide an AML training record for relevant staff. This is a requirement under paragraph 9(b) of the Code and regulation 24 of the MLRs 2017.

55% had not updated their practice-wide risk assessment to account for changes imposed by Covid-19 restrictions. This is a requirement under regulation 18 of the MLRs 2017.

50% had not updated their AML policy/procedures following the introduction of the 5th Money Laundering Directive in January 2020. This is a requirement under paragraph 9(a) of the Code and regulation 19 of the MLRs 2017.

45% did not demonstrate that adequate source of funds/wealth enquires were undertaken in relation to a transaction. This is a requirement under paragraph 11(c) of the Code.

40% could not provide a sufficient matter risk assessment. This is a requirement of regulation 28(12) of the MLRs 2017.

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 Legal Sector Affinity Group Guidance says:

The 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.

We would expect practices to investigate and satisfy themselves that the clients' reported income and wealth aligns with the documentation and information they have provided. For example, does their income and wealth correlate with their job role? Information should 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.

Matter-based risk assessments

CLC practices must have client- and matter-level risk assessments in place for every client and most matters. The Legal Sector Affinity Group guidance explains that matter-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 the risk is addressed in detail in the client risk assessment.

However, we find that conveyancers are often not undertaking assessments because they do not perceive a transaction to be risky. This is not good enough – you have to show you have considered the risk.

Also, it is not a one-time assessment – as a matter evolves, it may be necessary to revisit and adjust the assessment. Our revised template client and matter risk assessments, published in October 2021, says the matter-based assessment should be completed at the beginning, during the transaction if anything changes, and just before the exchange.

Digital ID checks

We have been struck by the speed with which many CLC-regulated practices were able to adopt digital identity tools in 2020 as they responded to the demands of remote working. Since that time, adoption has slowed despite the benefits in terms of confidence and security.

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 will offer 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.

China

In 2019, the National Crime Agency (NCA) issued a warning on Chinese underground banking. The warning was reiterated in the 2020 UK Risk Assessment.

It explained how the transfer of funds for personal purposes out of China by Chinese citizens is tightly regulated by the Chinese government, and in all but exceptional circumstances is limited to the equivalent of $50,000 per year.

"All such transactions, without exception, are required to be carried out through a foreign exchange account opened with a Chinese bank for the purpose. The regulations nevertheless provide an accessible, legitimate and auditable mechanism for Chinese citizens to transfer funds overseas.

"Chinese citizens who, for their own reasons, choose not to use the legitimate route stipulated by the Chinese government for such transactions, frequently use a form of Informal Value Transfer System known as 'underground banking' to carry them out instead. Evidence suggests that this practice is widespread amongst the Chinese diaspora in the UK." As money entering the UK by this route has left China illegally, these are not funds that should be accepted for transactions or payment of fees.

The NCA said evidence from successful money laundering prosecutions in the UK has shown that Chinese underground banking is abused for the purposes of laundering money derived from criminal offences, by utilising cash generated from crime in the UK to settle separate and unconnected inward underground banking remittances to Chinese citizens in the UK. The cash is frequently deposited into 'mule accounts' held by Chinese students as the first step in the process.

Last year, a Chinese mother and her two UK-based sons agreed to hand over London properties worth more than £1.6m in response to an NCA civil recovery claim that linked their purchases with suspected money laundering.

The family came to the attention of the NCA through links identified between a convicted money launderer and one of the sons. The NCA alleged that money the former paid into the latter's accounts was likely to have derived from serious and organised crime, having analysed evidence which showed patterns synonymous with underground banking.

Cryptocurrencies

Questions about payment by cryptocurrencies such as Bitcoin are becoming more frequent and can raise tricky questions given the widespread lack of familiarity with how they work.

Since January 2020, the Financial Conduct Authority has supervised how cryptoasset businesses manage the risk of money laundering and counter-terrorist financing – they must comply with the MLRs 2017 and register with the authority. It 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 cryptoasset or trade platform used, and whether it is regulated.

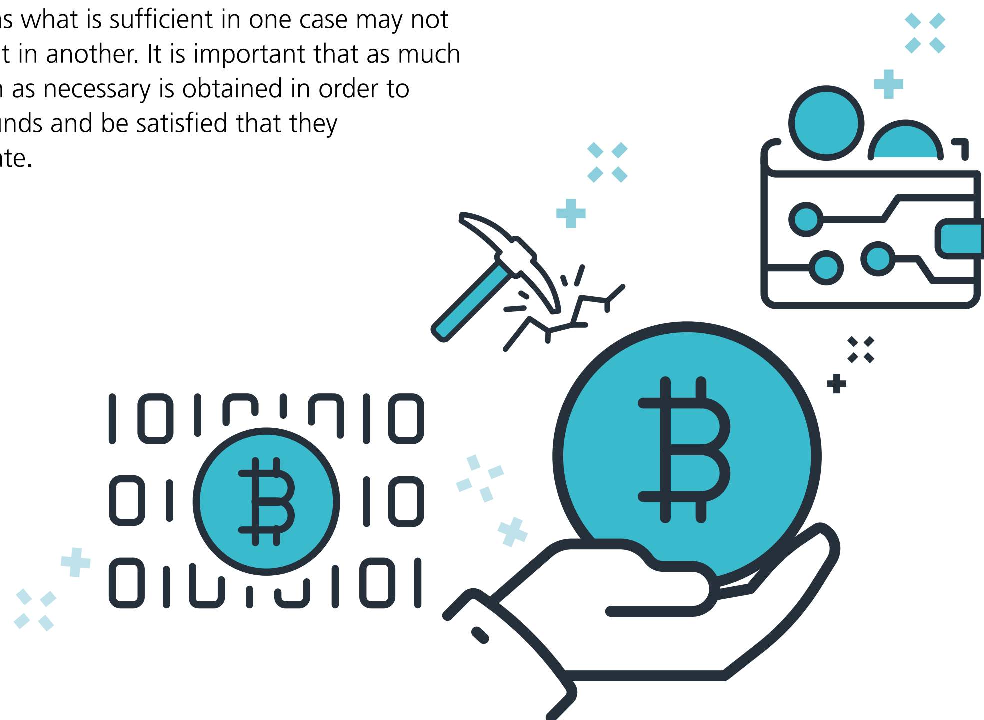
Ultimately, the same principles apply to identifying source of funds and wealth irrespective of where funds originate from. But currently we consider that the AML approach to transactions funded by cryptoassets to be similar to that of cash purchases.

We would therefore expect practices to adopt a risk-based approach and 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?

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. Insurers may have additional requirements regarding high-risk transactions, so you should take steps to understand your insurers attitudes toward accepting transactions which are funded by crytptoassets.



Sanctions

Russia’s invasion of Ukraine has put sanctions near the top of risk issues for law firms, given the influx of Russian money into the UK property market over the years.

CLC-regulated practices and individuals must be aware of the raft of sanctions imposed since February and the importance of adhering to them.

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.

There are two other key points to note. Firstly, while the current focus is on Russia and Belarus, the sanctions regime has a global reach and can apply to several nationalities and organisations.

Secondly, this is not an issue that will go away soon. If anything, it will be growing in importance due to recent events. Sanctions, along with economic crime, AML and cyber risks were already areas of increasing focus, and there will naturally be more of a spotlight on these issues from government, regulators, and the media, along with the public.

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 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.

Know Your Client

‘KYC’ is a very familiar abbreviation and there is a risk that this familiarity could undermine the importance with which it should be treated. Knowing your client is not just about the anti-money laundering checks, as important as they are. There is the distinct matter of sanctions to be managed too.

It is also vital that any lawyers understand who their client is, and what they want out of the transaction and why. This is perhaps the more traditional part of KYC that can get lost against the background of all of the other, more systematic, checks that must be made. Only that understanding of the client will ensure that you are truly able to act in their best interests, especially if they are vulnerable in some way.

Fractional developments are proving a major red-flag to insurers

Professional Indemnity Insurance

We have been warning for some time about the hardening PII market for conveyancers in particular. Aside from the pressures imposed by Covid and Brexit, insurers continue to be under pressure to improve profitability.

Last year, amid some insurers' additional concerns about the potential for claims arising from the very busy period created by the Stamp Duty Land Tax holiday, the CLC had to intervene after two insurers offered firms cover that did not comply with its minimum terms and conditions (MTC) of insurance.

It was a one-off intervention in response to extraordinary circumstances that added weight to the decision to review our PII arrangements.

This review was completed earlier this year, with changes aimed at easing the PII renewal process and providing greater clarity and confidence for everyone involved.

The changes practices need to know are:

Extension of PII cover

In the event that a practice is unable to renew cover, the last insurer must provide a 90-day extension of cover. It will attract a pro rata premium based on the most recent annual premium.

Practices may not take on new work during the extended cover period.

This provision will not be available to practices if their insurer has notified the practice and the CLC, no later than three months before the expiry of annual cover (i.e. 31 March), that the insurer will not offer renewal of cover at the end of the year. It will also not be available if the reason the firm cannot renew cover is that the CLC is taking action over regulatory breaches.

Run-off cover

We are maintaining integrated run-off cover. Insurers are expected to ensure that the annual premium they collect for PII cover includes a sum that reflects the risk of the insured firm going into run-off during or at the end of that insurance year.

Excesses

Last summer, one insurer tried to set extremely high excess levels to encourage certain behaviours by practices. We are not willing to compromise client protection by allowing freedom to agree excesses.

We will allow a firm to have a higher excess in very limited circumstances following a joint submission from the insurer and practice that makes a clear and compelling case. Over time, this oversight could be relaxed if we consider that the risk of high excesses has declined.

We have introduced a further band of maximum excesses for the largest practices, of a further 1% on fees above £1,000,001.

You must make sure that whoever is dealing with PII is familiar with the MTCs.

Quotes

Late quotes have been a particular problem. As a result, we are introducing a new requirement on practices to have submitted a PII proposal to at least one of the approved CLC insurers no later than 1 May each year. Insurers receiving such proposals will have to issue quotes no later than 1 June. Further proposals may be submitted by practices and quotes issued by insurers during June.

Insurers will be required to issue a practice's claims history within five working days of a request to do so.

We are planning to continue work with brokers and insurers to improve the availability of cover for start-up and firms transferring from the Solicitors Regulation Authority.

Premium non-payment

The CLC Licensing Framework has been amended to make explicit that CLC-regulated lawyers who have been managers in a practice that has not paid any required PII premiums will have this taken into account if and when they seek managerial positions in different practices.

Cyber cover

We will continue to explore how consumers can be better protected against cyber risks through insurance and regulatory requirements.

We encourage practices to consider taking out specialist cyber cover. The following are currently emerging as minimum requirements imposed by insurers:

- Use of multi-factor authentication for cloud-based services (such as email access) and for all remote access to a firm's network;
- No remote access without a virtual private network;
- Regular (at least annual) cyber-security awareness training, including anti-phishing, to all individuals who have access to a firm's network or confidential/personal data; and
- A segmented back-up solution.

Following these steps will reduce risk and also maximise the availability of cyber cover.

While some responses to our consultation supported mandatory cyber cover, there was also concern about its cost and the wide variations in what is provided by different policies.

The CLC is not currently in a position to define MTC for cyber cover and so more work needs to be done to define an approach, which may become clearer as the market in cyber cover matures.

In the meantime, we will review our guidance on best practice in cyber-security and ensure that practices have adequate measures in place.

Getting ready for renewal

Away from these changes, we are urging practices to think more carefully about the trading profile they present to insurers.

Too often, practices treat this as more of a marketing exercise about their firm, rather than how it presents them as a risk. You should explain the types of transactions you are prepared to act on and show the insurer that you understand the risks involved and have the processes in place to mitigate them.

The trading profile should also detail the specialist staff you employ, as well as the ratio, mix and balance of key personnel.

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.

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 mainly coming from 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 they are a client or not.

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. To help your decision, you might talk to your insurer about their view of the risks.

Aged balances

We wrote about this issue in the 2021 Risk Agenda, and it remains a live concern.

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 firms have aged balances on their books, and the amounts involved can quickly add up. We have seen firms 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 and can exist for many 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 they have done 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. Firms 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 firms do have residual balances, they should ensure they are reviewed on a regular basis and not left simply to age and accumulate.

Suspense accounts

Related to this is the issue of suspense accounts, which we are finding with increasing regularity. Their use should 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 identify the rightful recipient promptly.

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 firm'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.

Firms 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 firms 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 updated and substantially expanded our guidance on conflicts of interest. This discusses acting on both sides in detail, the risks and relevant issues, obtaining informed consent, and putting effective safeguards in place. We strongly recommend that practitioners read and implement this guidance.

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

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

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, 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 firms' compliance.

What are the risks?

CLC practices can decide the best way to display cost information, but we have found that some firms 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 – a link in a website's footer to 'regulatory information' is neither of these things. 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 firms must not require users to enter contact information before receiving a quote, unless compliant costs information is prominently displayed elsewhere on their website. If it is not, they should be clear that requiring users to enter contact information is optional. An alternative is to show examples of quotes for a range of property types as well so that users have a strong idea of what their quote is likely to be.

A reminder too to ensure that the CLC Secure Badge is in a prominent place on the website, and that firms 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 firm, too.

There are firms that do not have websites, but they are 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.

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

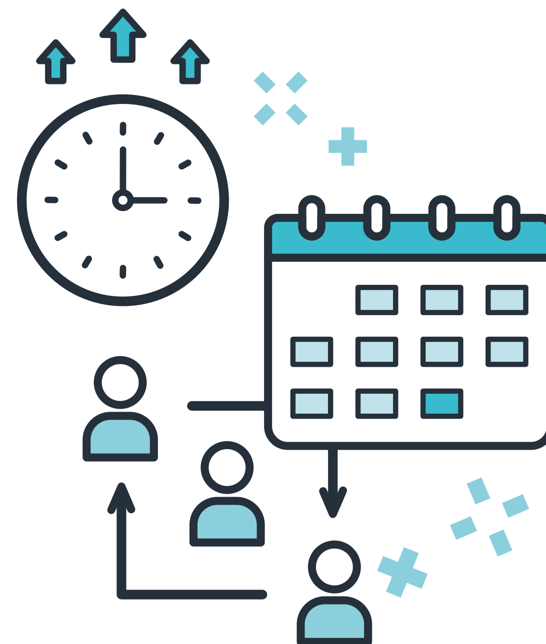
File storage

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:

- other conveyancing matters (other than the sale of property) 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 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 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.

In one recent case, a practice passed on all of its active files to another firm but abandoned 15,000 archived files at offices where the rent was not being paid, without any plan for how the data in those files could be secured or how clients could access those files should they want to. This was despite the CLC giving the firm clear guidance ahead of its closing that arrangements would have to be made for the files and notified to clients. The CLC had no option but to intervene in the firm to secure these files.

An 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.

Electronic file storage

Some firms 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.

Maintaining access 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 firms 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 (BCP) 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.

What are the risks?

The BCP has become increasingly important for all businesses. Firms need to think about how they operate and what their risks are (indeed, do you have your own risk register?). Does the BCP address them? 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 firm's managers responsible.

Some of the information you provide in your PII application – around the ratio, mix and balance of key personnel – should feed into your BCP; it is more than just saying what you will do if the office burns down.

All firms applying for authorisation for the first time have to show they have a robust BCP in place, including how the short-, medium- and long-term absence of key staff will be handled, as well as the planned or unplanned rapid closure of the firm.

The growth of ransomware and other cyber-attacks means you need to consider how you would cope with a complete loss of your data and in what circumstances you would pay a ransom. How would you keep transactions continuing uninterrupted?

Existing firms need to review their plan at least once a year – in our experience, they tend to be out-of-date, but it should be a live document that represents what your business is doing at that time.

This is particularly so as business ownership arrangements develop; decision-makers need to understand their responsibilities and their role in the event of the BCP being triggered.

An issue we are raising with firms, 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, particularly sole practitioners, have thought in detail about how their firm 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 in particular can have a higher turnover of senior legal staff.

The CLC wants to know that you have considered the risks and are 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 firm's bank account in the owner's absence?

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

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

Closing your practice

The hardening professional indemnity insurance market has led to firms closing down and in turn a focus on ensuring this is done in an orderly fashion. This is not always happening.

Other sections of the Risk Agenda – on PII, 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 firm that is shutting down, at which point it should not take on any new work.

Remember that you should notify us if your firm is at risk of financial distress. In a recent disciplinary case, both the law firm owner and a non-shareholding director were sanctioned for not considering the risk of financial distress; they only believed 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.

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

One of biggest risks in rapid closure is retaining enough staff to complete transactions, including post-completion work. This will need to be agreed with the CLC and insurers. One effective provision we have seen in business continuity plans is an arrangement with another firm to take the other's files; doing so will certainly assist in the smooth transfer of client files in the event of a shutdown.

We have come across examples of firms holding funds far beyond their closure date, not storing files appropriately and not making them available to clients, and undertaking work they should not. This can lead to disciplinary action.

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

Complaints and the cost of practising

The cost of the Legal Ombudsman (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 firms only generated an average of 256 cases – just 4% of the total handled by LeO – but the levy is a significant cost of regulation; in 2021/22, it made up £686,511 of the CLC's budget of just over £2.2m. More than six in 10 CLC firms do not generate complaints to LeO.

Until now, we have spread that cost evenly across the licensed conveyancer community through our practising fees.

In light of the ombudsman's rising costs, however, we have decided to introduce an element of proportionality that means those generating work for the ombudsman will pay more.

As a result, we have separated out the cost of LeO from other practising fees. All firms will still pay something towards the cost of LeO as there is a profession-wide benefit to its availability in terms of consumer protection.

But in the current practising year, we have charged 30% of the levy payment to 83 firms on the basis of LeO usage. We will increase the proportion to 80% over the next four years to give firms time to address their complaints handling.

We expect that this will incentivise firms and individuals to deal with complaints in a more timely and effective manner and will closely monitor the way they do this to ensure that they do not just pay complainants off.

Watch a webinar from the Legal Ombudsman on managing complaints here.

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The risk and impact of a cyber incident can be effectively reduced by segmenting, rather than separating, systems

IT resilience and recovery

Businesses of all sizes now suffer cyber incidents and law firms are no different. Readers will be aware of one very high-profile incident in the CLC community last year and that 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.

Difficult though last year's events were, they have provided a lot of learning that will benefit all CLC firms. One key message is that firms 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 firms 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' firm £98,000 for failures that led to a ransomware attack. The firm 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 firm 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 roster of these). Engaging external legal advice gives you the benefit of privilege, which can later be waived by you, 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?

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