

Briefing

RISK AND COMPLIANCE

ISSUE 09 | MARCH 2011

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Interview

Disaster? Fraud? It's all in a day's work

Olswang's head of risk and compliance, Tom Arrowsmith, on why law firms need risk directors, and how they can help boost profitability

Feature

Running risk

From client conflicts to conflict zones in Africa, risk management is about a lot more than just anti-money laundering

Plus

Good risk management means going beyond regulatory risk
The challenges to law firms of outcomes-focused regulation

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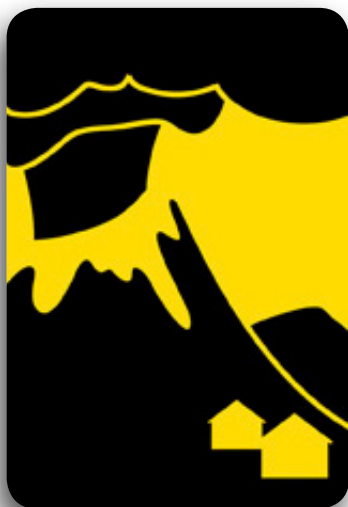
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Where are all the risk directors?



Preliminary results from our research into risk roles in the top 100 firms show that fewer than a third have a dedicated risk director (or equivalent) role.

At the moment, lawyer partners often cover risk management as just part of their remit. If this was the case in other regulated sectors, people would think we were still living in the

1980s. It's outmoded and needs to change.

Perhaps it's the traditional unwillingness to hand over key responsibilities to the 'support' side of the firm. Perhaps it's because partners can't see how risk is now a strategic issue that covers every part of the firm.

Whatever the reason, perhaps you should stick this issue of **Briefing** under

someone's nose to give them a start. In it we have Olswang's head of risk and compliance on why firms need risk directors, a feature-length look at the threats firms often aren't looking at, and analysis of what the new risks look like and how OFR might affect your firm.

I hope you enjoy the issue.

Rupert White, head of content and community



“With deregulation comes the ability to be innovative and spread into new markets. Risk plays an important part in determining the feasibility of entering new markets.”

John H Verry, risk director for TLT LLP

Interview: Tom Arrowsmith

Olswang's head of risk and compliance talks to Rupert White about tomorrow's world of firm-wide risk management



Feature: Running risk

From client conflicts to conflict zones in Africa, Lucy Trevelyan finds that risk management is about a lot more than just anti-money laundering



Proactive measures, please

Good risk management means more than just regulatory attention to detail, says Brian Lynch, risk practice group director of IntApp



Best outcomes?

Colin McArdle at LexisNexis Enterprise Solutions outlines the challenges to law firms of October's new outcomes-focused regulation model



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INTERVIEW

Disasters, security, money laundering... Just another day in the office, then

Tom Arrowsmith, Olswang's head of risk and compliance, talks to Rupert White about why law firms need risk directors and how teams like his can help firms do better business

The very top law firms are slowly but surely adopting a cadre of dedicated, director-level people whose task is to oversee every aspect of risk. They have the power to make changes and enough business nous to use that power to help the firm win business and stay ahead of the game. Does your firm have one of these people?

Olswang does, in Tom Arrowsmith. He's head of risk management and compliance, and he represents a growing movement of the responsibility for risk management into a

primary support role.

Risk isn't really a 'department' in the way that HR or IT are – perhaps that's why, of the top 100 firms, only around a third have a role that's in any way like 'risk director'. This doesn't mean legal sees risk as unimportant, but as risk directors are de rigueur in other regulated sectors, law firms look increasingly anachronistic by comparison.

What you call these people isn't important, Arrowsmith says, but whatever they're called, they need to become a central role in the law firms

of tomorrow. And the new regulation model from October 2011 – outcomes-focused regulation, or OFR – might push this further along, he says, as it demands firms have a compliance officer for legal practice (COLP).

But who will fill those shoes? In many firms, the required risk positions are currently held by the senior partner, the chief executive or the general counsel. But towards the top of the top 100, a new breed of dedicated risk chief is emerging. You can tell how nascent this job field is by the fact that

there isn't even a set title for it – pretty much every firm calls the role something different.

Whether the head of risk should be a lawyer or someone with a legal background – a view put forward by many – is matter for debate, Arrowsmith says, as there are "benefits and disadvantages in having a lawyer in the role and in having someone who isn't necessarily legally qualified – a non-lawyer manager will be able to bring all kinds of different skills that the lawyer won't necessarily have, particularly strategic and

INTERVIEW TOM ARROWSMITH cont.

commercial approaches.

"[But] do I agree that there should be a head of risk, mandated to look into every area of risk they think necessary in the firm and [be able to] have that discussion? Yes, definitely."

Powering compliance

Whether the risk chief is a lawyer or a manager, they need a good grasp of IT. "IT is completely fundamental, because you can't run any decent system or appreciate exactly how things work within your team unless you've got a very good view of how the IT works [in the firm] – how the systems actually operate, how a new client gets taken in and through to the end of a matter."

Arrowsmith says that the head of risk in a firm should take a lot of the responsibility for putting in place workflow systems in the firm, and at every stage in the client's matters "there should be thought given to risk management, and risk managers should have input into that process".

"It's not just an IT process," he explains. "You need a decent overview of risk and to understand what could go wrong."

Which is another reason that those with a background

outside legal might have an advantage, he says: "You're actually more likely to be able to take a black letter law problem and turn it into some kind of practical business solution. It's not the fault of the lawyers, but they're going to find it a lot trickier because they won't

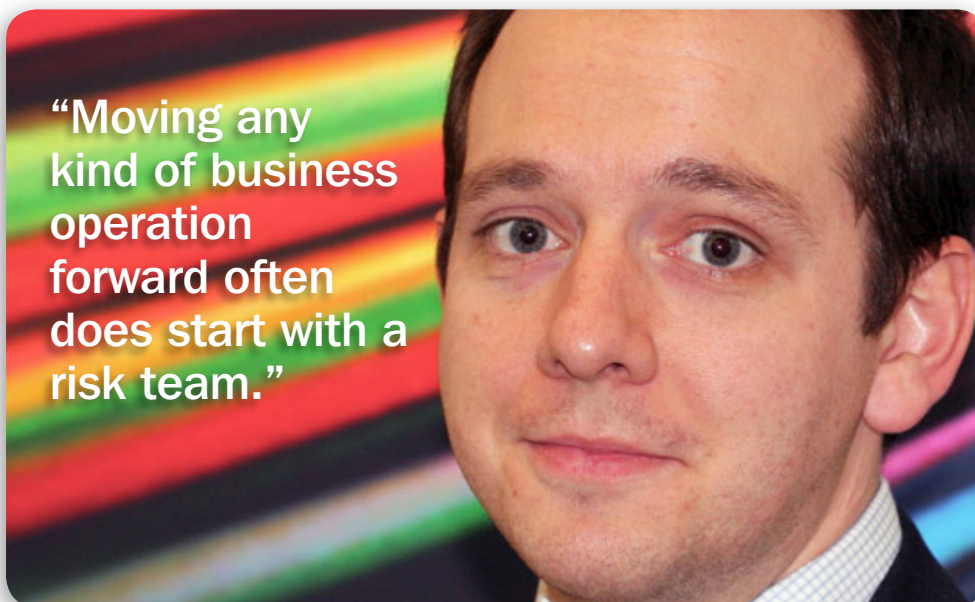
you're going to have the professional risk and compliance people and the people who are former lawyers."

But there still needs to be someone whose role is to 'own' risk. While this is the case in everyday practice in law firms, it's only when there

is responsible for everything from anti-money laundering (AML) to information security risk is that they can see how risk relates deeply to strategy. Everything a law firm (or any business) does in business has a risk edge to it – new ventures doubly so.

"When you're faced with a question like [setting] up a new office, there are so many different people who need to become involved in that [from the IT director to the BD people and HR]. What you need is someone who can take a global view of all the different things that need to happen to get that international office in place and who can always

"Moving any kind of business operation forward often does start with a risk team."



necessarily have the underlying understanding of how law firm systems work."

This doesn't mean that lawyers can't be great risk heads. In fact, Arrowsmith says, they can and should play a vital role in any risk team. "The former lawyers, the people with experience of actual client work, are going to be well placed to understand the practical realities of that work." He might say this, of course – before joining Olswang in 2005 he'd trained as a barrister.

"The best way to run a compliance team is to have the right mix of people, so

is a real dedicated risk chief that a firm can deal with risk in its every guise in a proper way.

Risk is strategy

The problem firms often have now is that risk is often seen in silos – IT directors, facilities directors and COOs, for example, owning areas of risk – whereas, as [risk specialist Mike Gorick says in our feature](#), everyone in a firm co-owns its risk. So risk is like IT or finance, in that it's a firm-wide infrastructural issue.

A good strategy reason to have a single risk chief who

be thinking one or two steps ahead and thinking: 'What could go wrong here? There's an underlying set of tasks that you need to do to move any kind of business operation forward, and often that does start with a risk team. That's what I've found.'

This firm-wide risk approach needs to be connected to a good firm-wide risk culture – which is the other large-scale thing a good risk chief should be responsible for, Arrowsmith says. At Olswang, he says, people are not only required to read the firm's manuals and updates, they also have 'tick box' requirements to say

INTERVIEW TOM ARROWSMITH cont.

they've read, understood and will adhere to them. It's vital to get this kind of active risk behaviour, because it's not good enough just to disseminate information – you have to create a risk-led culture that binds people to those instructions and helps them see that as good for business.

Even better is to build risk awareness into key performance indicators, Arrowsmith says. "That produces [a culture of risk and compliance]. You can set standards, such as a percentage level of the engagement letter coverage less than 'X' is just not acceptable. We've been doing that now for quite some time, and it feeds into the way that [partners] look at their appraisals at the end of the year.

"That is definitely the most effective way of doing it that I've ever come across."

If a firm isn't tracking how well the risk directives and directions are being adopted across the firm, Arrowsmith says, "and if you're not double-checking that it's happening in reality, then, first, you don't know what's really going on and, second, you arguably have not achieved anything by putting that policy in place in the first place".

Risk as client winner

Good risk management within the firm is mainly being driven by clients, but this has a hidden potential advantage to the firms that can grasp the business benefits of risk thinking. "There's definitely an extent to which it could be a differen-

tiator," Arrowsmith says. "I'll happily speak to the clients directly if there's, for example, AML issues, and ask how we can help." What he means is, for example, when a client is trying to do business internationally and they run into an AML hurdle, "is there any way that we can quickly call them up and try to lend our expertise"?

wrong. "Why not, as a risk and compliance team, help to advise the different [internal] teams who have to sign up to all kinds of supply contracts on what's in those contracts?"

But this isn't about trying to lever a team of 'no' people into every corner of the firm. Arrowsmith says the risk team has to approach pretty much everything from the position

"If you can try to approach every element of risk and compliance from the perspective that risk management makes good commercial sense, it's good business logic and it's a sensible way to go about things, that will help.

"Don't try to sell risk and compliance obligations as something you have to do because the regulator requires it – try to explain that it's the right thing to do because it assists your relationship with the client, and it assists with ensuring that we get paid at the end of a matter and that everybody ends up happy."

ARROWSMITH'S ANGLE

"[Our risk management skills] could be a differentiator. That's what we do for a living, so there's no reason why we can't add value in that way."

"That's what we do for a living, so there's no reason at all why we can't add value in that way."

And the risk team can bring a lot to the table internally, too. An example Arrowsmith gives of this is in helping the firm with supplier contracts, from courier companies to file storage: "The risk and compliance team has a vested interest in seeing what goes into those supplier contracts", he says, because those contracts will only come back to haunt the risk team should they go

of "not putting unnecessary barriers in front of any kind of progress".

"If the firm's looking to do something, work with them to try to work out how it can be done. Be flexible about it."

This is the upside of the job of the risk manager that really should come out more often – because they know (or they should know) that almost every area of business is strategically related to risk, they need to work with colleagues to help grow the firm, not to stifle it.

What clients want

"You can conduct AML checks strictly because of the Proceeds of Crime Act and the money laundering regulations, but you can also do it because you should want to know who your client is. You should want to know what they're about, who's pulling the strings, and you should want to appreciate what it is that they want to achieve out of a particular matter."

You should want to know everything not because it's investigative, he says, but because this knowledge will give the firm a key insight into how the client will judge that their needs have been met. This is becoming ever more of an issue because it's the clients that are demanding ever more concentration on risk, and risk across a variety of vectors, especially informational risks like confidentiality and information security.

INTERVIEW TOM ARROWSMITH cont.

Clients are now turning increasingly to procurement people to work with their suppliers, including law firms – which can be the bane of the BD person's life, as we found out in our Briefing on marketing and BD – but this has another effect on law firms: it has started to push risk in many previously minor areas (to a law firm's mind) high up the agenda, such as information security, business continuity and data protection, Arrowsmith says. "They're very sensible and they want to make sure we're doing everything that we can to maintain confidentiality and to protect their data."

Ups and downs of OFR

Closer to home, from October law firms will have a whole new world of regulation to deal with in OFR. The problem is that no one quite knows exactly what it will be yet.

What we do know is that it won't be based on a prescriptive book of 'must do' lists and, most urgently, it might be impossible, at least in the early days, to guarantee that the firm will not have done something that gets it into trouble for non-compliance.

"[OFR] is going to be a top priority at the moment for every single head of risk. In reality it's going to require a root and branch review of all existing procedures, but not necessarily [to] amend every single procedure," Arrowsmith says. What risk heads will have to do is decide whether or not what

they've got in their current manuals meets the 'indicative behaviours' demanded under OFR. "Provided they do that, that's a good indication that the outcome is going to be accomplished."

The difficulty, he says, with 'outcomes' is that "there's actually less clarity than there was previously. Lawyers do prefer clarity – and directors of risk up and down the country

you won't complete the outcomes, even though you're doing something which was substantially similar to what you've done previously."

How can a firm deal with this fundamental insecurity? Turn the rulebook into a series of conversations, he says. "We're going to have to do a lot of education and training, and explain to people that what they need to do is they

"It's going to be very difficult to categorically say whether something is compliant or not with the new code. It's very much an 'after the event' analysis."

Tom Arrowsmith, head of risk and compliance, Olswang

would prefer more clarity".

"It's going to be very difficult to categorically say whether something is compliant or not with the new code. It's very much an 'after the event' analysis."

In essence, the Solicitors Regulation Authority appears to have introduced a measure of risk into the world of risk, which would be ironic if it wasn't so serious. "There's a level of certainty which has been taken away," Arrowsmith agrees. "There's a risk that

need to really consider what the outcome of their actions will be. We may well be on the phone a lot more than we used to."

But OFR isn't all bad news. "There's going to be a welcome amount of flexibility to it," he says. "It won't be nearly as huge as the current code, so it will bring a welcome sense of proportionality", he says, and it should be easier for mere humans to understand, which is "very sensible".

Ultimately, Arrowsmith has two key pieces of top-level advice for risk heads who will be dealing with these new challenges and this new regulatory environment: use real examples of compliance or risk failures to drill the issue into people, and use technology to help automate risk mitigation wherever possible.

"You should use the IT system to tell you where these things aren't being done properly," he says. For example, new client inception should prompt AML steps, and it should be a chance to have a look at the credit risk associated with the client. It should also be a broader chance to look at how to engage with the client in terms of risk and business – engagement letters and terms of business, for example. "That all begins with IT," Arrowsmith says, "because these are effectively IT processes, taking a matter from the beginning of its life at the firm to the end."

And risk education, possibly the most important thing, needs to focus on real examples that have come out of the firm, "where things have gone wrong, risks which the firm has actually felt and experienced" – war stories, in other words.

If you can present real examples, he says, "it's very, very difficult for the lawyers to say 'that can't happen here, and isn't relevant to us'". ●

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FEATURE

Running risk

Lucy Trevelyan looks at the world of the risk director. From client conflicts to conflict zones in Africa, she finds that risk is about a lot more than money laundering

Risk is everywhere in legal business, but as a business services role in law firms, rather than a partner responsibility, it's still relatively new. Does that need to change, as a new regulatory environment rolls in? Or have law firms already found the right way to run risk?

In a law firm, you can't be too paranoid – risk can rear its head anywhere, from cleaners spilling things into PCs to receptionists leaving client letters on display; from failures in conflict checking to partners leaving laptops on trains. All these things can and do happen, and they can devastate a firm's reputation and, ultimately, its bottom line.

But who does this vital job, and are they right people? Is it the case that only lawyers can be true risk chiefs in law firms, or is that just old-fashioned 'you're either a lawyer or

you're not' thinking? And, whoever does the job, are risk heads really looking at every aspect of risk?

A decade ago, says Martin Baker, risk management partner and MLRO at Taylor Wessing, the concept of risk management in law firms just didn't exist – but it has moved to the top of the agenda over the past four years or so.

The demand for more stringent risk management strategies has come from clients. By itself that fact isn't surprising, but clients are also concerned about a much broader spread of risk vectors than firms might even have realised existed or mattered.

According to the UK edition of the [2011 Law Firm Risk Survey Report](#) – a survey of risk heads from the 100 largest UK law firms by the Risk Roundtable Initiative, an IntApp-backed initiative – 90%

of respondents said clients are showing greater concern about risk management and mandating more stringent measures. Nearly half (47%) said their clients see risk management as a key priority. A fifth (21%) said clients saw risk management as a way of differentiating the firm.

In other words, one in five risk people say clients believe that the way a law firm handles risk may define whether it wins their business.

However, 74% of risk chiefs polled said that lawyers saw risk management as "necessary but inconvenient" – support staff figured only slightly better – and only 21% of them thought lawyers and staff saw it as a "key priority". It can only be described as scary that 5% of risk people thought lawyers saw risk management as "unnecessary".

Baker says breach of confi-

dentiality and data protection are issues about which clients are particularly concerned – prompted, perhaps, by recent high-profile cases of data losses. "These cases didn't involve law firms, but law firms do have a lot of sensitive data – clients are more tuned in to these issues and are concerned about them."

Kim Hobbs, co-head of risk and compliance consultancy Compliance Check and practice manager for north London firm Curwens, says that, when working on strategic risk management, it's essential to calculate senior management's collective attitude to risk and to educate them on the need for risk management.

"A framework can [then] be developed that the team can embrace, and that everything builds upon. This task will almost certainly demand a great deal of time up front

Running risk cont.

[but later] decisions about risk management in specific areas will be simpler.”

Baker says risk is or should be “a standing item on every agenda, and that’s before the Solicitors Regulation Authority [SRA] starts getting involved with the new outcomes-focused regulation [OFR]”.

OFR your head?

OFR – which will see the SRA’s detailed rulebook replaced with a risk-based approach founded on ‘outcomes’ and behaviours – is right at the top of most law firm risk managers’ agenda.

The SRA board recently approved the final draft of its handbook, due to be published 6 April 2011, which sets out the new regulatory arrangements to support the introduction of OFR in October.

Baker says he thinks OFR is the right way forward for law firm regulation, but that the jury is out on whether enough time has been given the sector. “The need to establish robust audit trails to demonstrate compliance is concerning a lot of risk managers.”

He says there is real concern about the uncertainty and cost of compliance – extra costs will arise in recruitment, in partner time and in devising and introducing procedures.

“It is going to be a significant exercise for many firms.”

Many City law firms are concerned that the SRA may not be correctly focusing its resources or demonstrating a full understand of the needs of City firm clients, as distinct from those of high street firms.

To worry about whether the consumer is protected “is absolutely right”, he says, “but for a practice dealing with sophisticated multinational clients, [clients] will let you know if they think they are not getting the right level of service. If you don’t provide what they want, you won’t get

able to achieve that objective unless they are part of the senior governance structure of the firm”. The SRA has clarified its intentions a touch, he says, by saying it will not look solely to the COLP for delivery of the ‘required outcomes’, and that the overall responsibility will remain with the senior management body of the firm.

But can risk managers really ensure board buy-in for a pervasive firm-wide risk strategy without having someone on that board?

Frank Maher, partner at

GC roles: “Some firms take the view that, in the case of general counsel, there should be some separation of functions”.

Risk and the board

But that’s an issue around GCs – if risk management is moved to a dedicated support role, there’s no reason it can’t be at board level.

Penningtons’ risk and compliance manager, Marcus

Shepherd, says that if risk chiefs are not embedded at board level, there must be good communication between the two camps, and that risk management must always be prioritised with the resources available. “This prioritisation needs to be closely linked with what the business strategy is.”

It is critical too,

he says, that risk heads work with all support departments, or they simply won’t be effective.

If risk managers operate at board level, Gowans says, it’s easier for them to ensure a risk management culture is embedded in the firm from the top down. His firm’s risk team includes an equity partner, former practising litigation and regulatory lawyers, risk



“Risk is at the heart of strategy. If you are opening in a new country or practice area, or taking on a high-risk client, it affects risk.”

Frank Maher, partner, Legal Risk LLP



instructed again”.

The new regime has also attracted criticism because of the strict requirements for the compliance officer for legal practice (COLP) role, which each firm must have in place by March 2012.

Osborne Clarke’s risk partner, Andy Gowans, says there is concern at many firms that “potential COLP appointees are unlikely to be

Legal Risk LLP, says risk is at the heart of strategy. “If you are opening in a new country or practice area, or taking on a high-risk client, for example, it affects risk, hence the need for the risk culture to be embedded into everything the firm does.”

But whether risk chiefs should be a member of the board is open to debate, he says, especially if they’re in



'professionals' and someone with IT systems and projects experience, as well as non-qualified staff with conflicts-checking experience.

He also calls on expertise from heads of HR and finance, he says, and external auditors bring an "outsiders' view and a wealth of experience in risk management for law firms and other professions".

But Gowans has mixed feelings as to whether there is a need for more 'professional' risk people (ie from business rather than law) in law firms. While they can bring "excellent skills and valuable perspectives from other professions and industries", he says, "I would be concerned that 'importing' a non-lawyer risk professional as the sole risk management function may be unrealistic for many firms".

To be effective, he adds, the risk management strategy needs to be embedded at the core of a firm's culture, which takes time "and is intrinsically difficult for someone without 'insider' status and credibility to achieve".

Paul Howard is Wragge & Co's first general counsel with particular responsibility for risk management strategy, and represents the opposing view. A retired Wragges partner, he believes it would be far more difficult to do his job had he not been with the firm for many years. "[For] all the things you get involved in – confidentiality, conflicts, legal issues – you need to understand the legal practice really well." Wragges doesn't have a risk manager on the board per se, and Howard is

not convinced it's necessary.

Mike Gorick, associate at The Compliance People, is of the opinion that every member of a firm 'owns' the firm's risk, and this needs to be instilled with training. But the buck still stops with the partners and the MLRO.

"Risk should be overseen at the top. Too often the risk management appointee used to be someone at a lower

look towards the legal regulatory areas more than any other 'business' regulations that apply – and this is the wrong way to look at it.

"The risk manager should have an oversight and responsibility for all compliance, not just that which applies to legal transactions and the code of conduct. This is a tall order, and medium and large firms may require a full-time senior

instant and unguarded statements of fee-earners, or others in the firm, to go out, which might damage a law firm's reputation".

Firms should have internal rules and procedures about what can and can't be said using a firm's Twitter account (often called a social media policy), he says, but the difficult part is how one addresses the risks arising from employees using their personal Twitter accounts to blog about business-related issues, and unintentionally disclosing client details or price-sensitive information. "It's a significant risk, and I think sooner or later a law firm is going to get caught out."

New risks have taken over from the old spectres because firms have done well to deal with the old enemy, money laundering. Compliance problems still arise though, Maher says, because of insufficient attention paid to ongoing monitoring and procedures where additional measures are required to be taken, such as clients that aren't face-to-face, and politically exposed persons (PEPs). Also currently moving up the regulatory agenda, Maher says, is compliance with sanctions legislation, an area very much in the public eye with UN sanctions and recent events in Libya and Egypt.

Closer to home, business continuity is another area increasingly seen as a significant risk – with extreme weather, technical failures and reputational risk issues all capable of interrupting any business. Disasters are sadly

"Twitter is a significant risk, and I think sooner or later a law firm is going to get caught out."

Martin Baker, risk management partner and MLRO
Taylor Wessing

level, perhaps a good secretary who really knows the firm. But it's difficult for them to be seen as having the authority they need, or [even attain that authority] as they have come up through the ranks."

Sometimes, he says, delegating authority to an external source, especially if that source is authoritative, may be much more effective than an in-house person without any clout.

OFR comes, in essence, from the financial services sector, which now looks at risk in a very 'holistic' way. In legal, Gorick says, lawyers tend to

appointment." But, he says, this can pay for itself.

New risks, new rules

Whoever carries the risk management yolk, they're continually facing new types of risk. Increasingly sophisticated technology creates a new batch of possible terrors – social media and data protection are topics currently climbing the list of risk management *bête-noirs*.

Baker at Taylor Wessing says that Twitter is a particular concern, because "it allows

Running risk cont.

big news at the moment, but even the more 'normal' ones, such as snow or flooding, should fall to the risk chief.

Risk managers can make good business continuity co-ordinators or controllers, Shepherd at Penningtons says, because during incidents they don't have direct responsibility for recovery, so they're able to focus on coordination and communication.

New business and risk

But risk is also, as Maher pointed out earlier, about strategic goals, and making sure the firm succeeds and makes profit. John H Verry, risk director for TLT LLP, says the imminent threat of alternative business structures and competition in the market in general are points also preying on the minds of risk heads.

"The legal profession is not giving enough credence to the potential impact of new players; strategic risk is a key area. With deregulation comes the ability to be innovative and spread into new markets. Risk plays an important part in determining the feasibility of entering new markets."

Verry says the proposed changes to the professional indemnity arrangements for the profession also trouble him: "Removing financial institutions from minimum terms cover this year will have a big impact potentially on a firm such as mine."

Who does the firm's work will be a big part of future business – and outsourcing and offshoring are big issues

for risk managers, because outsourcing pushes risk outside the wall of the firm and creates a real need for a firm-wide approach to risk.

Outsourcing is only going to get more front-of-mind after [the SRA announcement in November 2010](#) that it will be assessing the impact on the legal profession and its clients

Clarke says, that firms that don't realise they are involved in outsourcing will be affected in unanticipated ways.

"Many payroll services, document archiving and deeds storage, company incorporations, process servicing and IT services hosted on external servers may all involve

its own resources to carry out a particular mandate, the SRA will view the engagement of specialist lawyers from a different firm, or lawyers from a firm in a different jurisdiction, as within the definition of 'outsourcing'."

Under current SRA rules, the main regulatory issue with outsourcing concerns client confidentiality, data security and data protection. But, Gowans says, the business, strategic and market risks are far wider.

Firms considering outsourcing, he says, should consider a multitude of risk factors, ranging from the information security risks to reputational ones, from financial risks down to plain old people problems.

For firms of all sizes, risk is a big issue that will only become more pressing as the legal market, and the way it is regulated, changes – and it touches every role in a firm.

One thing is clear: the role of a risk chief can no longer be restricted to areas which the management board sees as appropriate. It must instead be a proactive and all-encompassing role, with intense and ongoing liaison with business services and legal staff. Every decision made by management and support department heads ideally needs to be scrutinised for risk issues, and it is hard to see how this can happen unless the leader of a firm's risk team – whether he or she is a lawyer or a manager by background – has a seat at the top table. ●



Outsourcing and risk



Andy Gowans, Osborne Clarke's risk partner, outlines some of the risk issues around outsourcing

Project and execution risks: Properly define the services to be outsourced – vital for setting out a meaningful service level agreement with the provider of outsourced services.

Human resource risks: How will the personnel to be outsourced be treated, and what will the morale impact

be both for those that are outsourced and those not?

Financial risks: How financially stable is outsourcing business, and are they insured for mistakes on legal process outsourcing?

Strategic/competitive risks: Is there a threat from the client eventually going direct to the outsourced provider in an LPO arrangement?

Reputational risks: Is there a danger of a perception that a firm offering LPO services is moving to the 'commodity' model, and aiming for lower-value work? If something goes wrong at the outsourcer's end, what is the reputational blowback to the firm?

of outsourcing and offshoring arrangements, through a "thematic review".

The SRA says it will take a broad view of what constitutes 'outsourcing' – so which means, Gowans at Osborne

the potential for third party access to confidential information, which could be covered by the review.

"There is also some indication [in the SRA's move] that where a firm does not have

ANALYSIS RISK MANAGEMENT

Proactive measures, please

Good risk management means more than just regulatory attention to detail, says Brian Lynch, risk practice group director of IntApp

Heading into 2011, the rules for risk management within law firms are changing.

Information risk in particular has taken centre stage in law firms, as new regulations, clients and insurers have asserted risk management demands, and have moved to a 'trust but verify' approach.

This October, outcomes-focused regulation becomes the Solicitors Regulation Authority's method, a departure from its current rules-based approach. This is both freeing and taxing.

Currently, requirements are well-described, albeit not altogether useful. In the new model, mandatory outcomes are described, with optional supporting indicative behaviours. Within the revised Code of Conduct, firms are required to "have effective systems and controls in place to enable you to identify risks to client confidentiality and to mitigate those risks". Though the term "effective" is currently undefined, the SRA will conduct an audit of any firm it deems may have fallen short of this mark.

This isn't the only area of compliance to which law firms must pay more attention. ACS:Law fell foul of the Data Protection Act in late 2010 following a massive leak of personal information. ACS:Law ultimately closed because of the debacle.

Regulators are not the only ones exerting new pressure. Major corporations subject to

industry-specific regulations now want to share risk with their law firms.

Whereas firms typically advise their clients on the best methods to minimise risk exposure in any negotiation, clients are now demanding their firms also reduce their own exposure. Many government agencies, for example,

require attention to risk due diligence to ensure that firms have proper controls in place.

In the face of regulatory, client and insurer pressure, therefore, prudent firms should continue expanding risk management efforts with investments in staff, technology and management attention. The alternative –

compliance knowledge, and IT should highlight innovative methods to protect the enterprise.

● Document and communicate protocols

Developing and perpetuating a culture of risk awareness ensures an organisation works as one to prevent avoidable breaches or unsafe behaviour.

● Use technology to free up risk staff to focus on higher-value policies and procedures

Information risk management has become too unwieldy for manual processes. Technology can monitor for abnormal behaviours or ensure access controls are in place.

● Explore separate cyber insurance policies

Data breaches can be very expensive. PII may cover this, but it will affect the renewal cost. Smart firms are shifting their risk to a distinct policy.

Effective risk management results in a more attractive firm, to regulators, clients and insurers. A commitment to risk management will also drive business development, and insurers will reward less risky clients with lower premiums – and forward-thinking firms are finding that the proper combination of technology and process help them benefit from those advantages.

"Waiting for issues to crop up is not a strategy for success."

Brian Lynch, IntApp



now require ISO 270001 certification from firms.

Beyond IT-specific risk areas, clients are demanding that firms have controls and monitoring in place to protect them from severe reputational harm. Robust risk management has become the new standard of care.

Insurers are also exercising their buying power and looking for ways to mitigate risk and reduce claims. Professional indemnity insurance (PII) regularly ranks as one of the top expense items for firms. In the underwriting process, insurers

waiting for issues to crop up and responding reactively – is not a strategy for success.

There are some key steps firms can take to ensure consistent compliance and effective risk mitigation:

● Assign staff dedicated to managing risk

By dedicating manpower to predicting, identifying and mitigating risk, firms can move to a more predictable, proactive approach.

● Align risk and IT management functions

Risk managers should arm their IT colleagues with

Click for more on law firm risk management with IntApp



ANALYSIS FUTURE REGULATION

Best outcomes?

Colin McArdle at LexisNexis Enterprise Solutions outlines the challenges to law firms of outcomes-focused regulation

This October will see new regulation for legal service providers, creating alternative business structures and transforming the sector.

There is rationale behind these regulatory changes: promoting diversity, increasing competition, improving access to justice and ultimately protecting consumer interest.

The Legal Services Act requires the Solicitors Regulation Authority to support the act by encouraging transparency and accountability in legal services providers. To this end, the SRA has developed an '[outcomes-focused regulation](#)' (OFR) approach, in an attempt to move away from the prescriptive mode to a more qualitative way of measuring professional conduct and legal service delivery. The onus of compliance rests squarely with the legal services providers – they face potential risks of severe financial penalties in the event of non-compliance.

The challenge for legal services providers is that these new regulations are open to interpretation, increasing the risk of non-compliance. Firms need to self-assess, self-certify and proactively report on their state of compliance to the SRA. Creation of new

risk job roles, such as compliance officer for legal practice (COLP) and compliance officer for finance and administration (COFA), will become mandatory and are aimed at enabling firms to deliver those requirements to be proactive.

Law firms have a lot of processes to turn into a self-assessment process.

A good example is on-boarding a new client as part of demonstrating client care – a key focus area of OFR. Firms need to conduct anti-money laundering (AML) checks, establish proof of identity, ensure that the client has funding in place and is aware of all relevant options, and have templates for all types of client care letters and inform the client in writing of the complaints procedure. Legal services providers also need to assign practitioners with the right experience to the client and closely monitor service delivery for quality.

These challenges will be compounded for firms that outsource the delivery of their legal services. The SRA can request access to records or entry to third party premises in relation to outsourced activities or functions at any time.

Legal service providers also need to publish an 'equal

opportunities and diversity' policy that is available to clients. Alongside these risks lie processes around conflict of interest, confidentiality and disclosure, and law firms need to put in place safeguards, including information barriers, that comply with common law, such as ethical walls and files and security settings.

Automating compliance

Manually executing and monitoring these processes takes a great deal of time and is very heavy on admin – and is costly and prone to human error. Adoption of workflow technology, however, to automate business and legal processes, can deliver real risk-led, compliance-related advantages to firms.

Such technology aggregates data from various sources and can deliver useful risk data about the firm quickly and easily. For example, AML checks are immensely time consuming and tedious tasks – but through automating the due diligence process, they can, to a large extent, become foolproof and routine. This enables firms to undertake client screening and ongoing monitoring in line

with a risk-based approach to work, and provide complete audit trails to demonstrate evidence of the process and the results obtained for compliance purposes – vital in an outcomes-focused world.

Evidence of a risk-based approach to compliance also gives firms the capability to identify and quantify the risk potential of a client or matter as part of a workflow, which can substantially reduce professional indemnity insurance (PII) premiums.

Using technology to automate compliance-related processes is the only fail-safe solution for law firms. Such an approach aligns regulatory compliance with risk management and overall business strategies, minimising the financial and reputational risks of non-compliance.

Ultimately, the goals of the SRA are not different from those of law firms: ensuring firms are run in accordance with proper governance and sound financial and risk management principles, to give legal service customers the best possible service.

Email LexisNexis
about how technology
can mitigate firm risk

