

Frank Maher says legal firms need to protect themselves from being targeted by fraudsters

Law and disorder

Reports of an alleged £10m fraud on the Cheshire Building Society should ring alarm bells among professional indemnity insurers, not only for valuers but also law firms, and top-up insurers should be particularly concerned.

Rarely are valuers subject to fraud claims without an eye being cast over the role of the solicitors with a view to involving them in proceedings.

The scale of the Cheshire problem is as yet hard to predict accurately, but preliminary indications are that it will be far-reaching and the Serious Fraud Office is investigating.

Press reports indicate that Société Générale may also be a victim.

On 2 April, the FSA issued a press release warning lending institutions of the problem. The FSA also announced on 12 April that it had launched an initiative with the Council of Mortgage Lenders to set up a streamlined reporting system designed to reduce the level of fraud involving loan applications handled through mortgage intermediaries.

Meanwhile, professional indemnity insurers have, for some time, been seeing an increase in large fraud claims against law firms. One major insurer of law firms attributed 25% of claims over £1m to fraud.

Announcements by the Assets Recovery Agency of assets seized relating to alleged terrorist financing in Northern Ireland and links to ownership of property in Greater Manchester will not have gone unnoticed either.

Targeting law firms

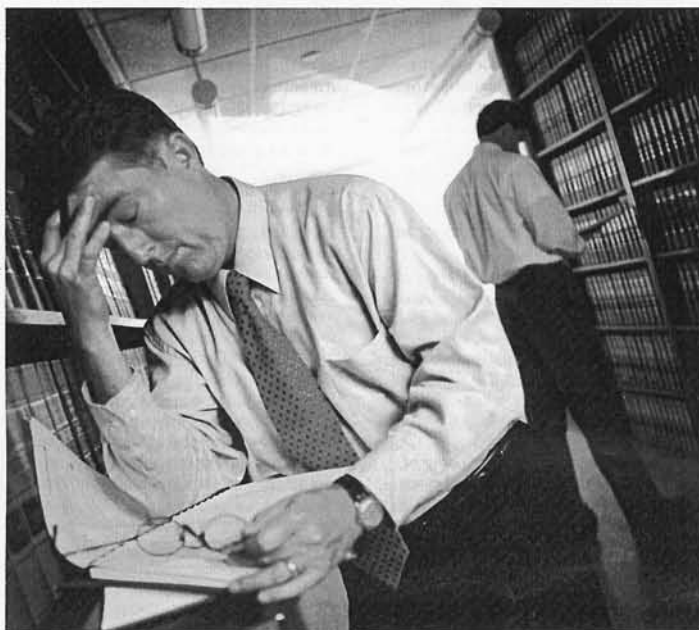
Fraudsters will often target apparently respectable law firms to clothe themselves in an aura of respectability. Often the lawyers have overlooked warning signs of fraud, rather than being directly involved in it themselves.

A memorable exception investigated by the writer on behalf of insurers some years ago, with shades of Michael Gilbert's novel, *Smallbone Deceased*, involved two properties which had been knocked into one. The valuer for the first lender went through one front door, put a value on the whole property, and a loan was granted for 90% of the valuation.

Hard on his heels, the valuer for the second lender went through the other front door and the process was repeated. Each lender lent on the full value of the whole property, and as there were two sets of deeds, each thought it had full security. The solicitor was later struck off.

One can but hope that increased registration of title and the associated filing of plans will reduce this risk for the future.

One major firm found itself a victim



recently after taking on a team of commercial property lawyers with inadequate checks on the lawyers. Even many large firms fail to carry out adequate checks on lateral hire partners from other firms, as revealed by Legal Risk's recent Top 100 law firms' professional indemnity and risk management survey.

Basic checks

Although the situation has improved substantially in the past three years, there are still basic checks being left undone. These include such things as resumes (checked by only 89% of firms), claims and disciplinary records (74% and 79% respectively), and even whether the recruit has a current practising certificate (94%).

Lack of a practising certificate caught out a partner in one major international law firm, for whom the writer acted, and it was not the first time the firm had been caught, as a former partner had been found not even to have qualified as a solicitor.

Fresh in many minds, too, will be the recent case of solicitor Michael Fielding, jailed for eight years after absconding to South America, having admitted stealing more than £6.5m of client money and pleading guilty to 113 charges including 24 of theft.

The methods adopted are usually quite simple. In the latest cases, it is alleged that the over-valuation was based in part on fraudulent leases with inflated rental figures. Similarly, with residential property, borrowers may be tempted to inflate their income on loan applications, easier to do in cases where self-certification of income is involved, though the FSA has issued guidance on further checks lenders might usefully make.

Sales to connected parties have also been a traditional means of fraudulently inflating

the apparent value of property, with a series of sub-sales in which the sale price increases with each transaction.

Identity fraud ought to be less of a problem with firms now being required to carry out money laundering checks, but is still identified as an issue by the FSA because of fraudulent documentation such as passports, driving licences and utility bills.

Law firms could undoubtedly do more to protect themselves. The writer has investigated numerous multiple mortgage frauds on behalf of insurers where lawyers have been party to the frauds, and the 'red flags' are invariably there – often seen and ignored. High living, personal debt and – interestingly – involvement in football clubs feature frequently.

It seems the last point is not confined to the UK. The writer mentioned it at a gathering of insurance brokers in Europe recently and the problem was recognised by a delegate who had also encountered a major claim involving a lawyer-director of a football club.

The Michael Fielding case referred to earlier was a case in point so far as personal indebtedness was concerned, as the law reports of the possession proceedings brought by the bank in relation to the matrimonial home reveal personal debts of several million pounds.

Risk areas

Risk areas include lack of systems, particularly internal file review, at which solicitors are notoriously bad, clients who are in some way connected to the lawyer – such as directorships and trusteeships or relatives, and unusually large transactions compared with the rest of the firm's practice. Firms with financial problems can also be high risk.

These include trading difficulties, repay-

ment of former partners' capital, and loss of key players. There are other risk areas too.

Excess layer insurers will have particular cause to be concerned, given recent changes in the aggregation clause in policy wording, which makes it more likely that claims arising from similar causes will be treated as one with one policy limit, pushing more claims through the primary layer into excess layers.

So what should insurers, and particularly excess layer insurers be doing about it? They need better assurance of what the law firm does in relation to its risk management. Some insurers recognise that a proposal form is a self-serving display of all that is right in the firm.

A lengthy risk management procedure manual annexed to it is worthless if it does not actually happen on the ground. Often, the firm has grown since it was prepared, and it has not been revised to take account of new risks.

Independent evaluation

An independent pair of eyes can add value in helping underwriters pick the better risk, as well as helping the firm itself identify areas for improvement and examples of best practice used by their competitors.

An independent evaluation of a firm, paid for by the firm with underwriters' encouragement, should effectively be self-funding, as experience shows that a significant risk issue will usually be found which is capable of being put right at low cost.

Setting the cost of a report against the premium if the firm takes out the policy is a small price for underwriters to pay for helping identify the better risks, and ensure that the firm starts the policy year with a fresh look at its risk management.

A recent example, conducted by the writer's firm, involved a risk assessment on an eminent international law firm. One department had a key date back-up diary system, but the risk management partner was unaware that the system had not been operational for some weeks because the individual who operated it had been off ill: something easily put right once it was spotted, but with dire potential consequences if it went unnoticed.

Perhaps surprisingly, it is the writer's invariable experience that staff speak very openly when interviewed by outsiders about risk issues, perhaps seeing it as an opportunity to get something off their chest. Experience to date suggests that independent risk assessments on law firms are primarily obtained at the request of primary layer insurers.

But risk assessment is not only an issue for primary layer underwriters: excess layers beware – the aggregation clause may bite. IT

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