

# Managing risk in a credit crunch

Carrying on the theme from the writer's article in the last issue, managing risk in a credit crunch requires extra measures. The focus on declining business and bills unpaid may distract partners from thinking about wider risk issues and identifying those that may be created or more prevalent in an economic downturn. Here are a few more to think about and address.

'Physician, heal thyself' is no more apt than in the field of redundancies, on which law firms may advise clients extensively while overlooking the need for their own compliance. With unprecedented numbers of law firm redundancies, law firm partners and management should note the £2.8m award in favour of a £100,000-a-year bank employee for unfair dismissal and racial discrimination (appeal pending).

Departing lawyers may mean unfinished matters – do your procedures ensure proper handover? It is important too to bear in mind that the firm's accumulated wealth of knowledge may walk out of the door: lawyers have a disconcerting habit of regarding confidential client documents as 'their precedents'.

People react differently under stress, whether the looming spectre of redundancy or otherwise, and they may be under financial or other stress in their private lives as well as their professional lives: press reports indicate significant increases in helpline calls to LawCare, the Solicitors Assistance Scheme and the Solicitors Benevolent Association. The need for billing targets to be maintained may encourage lawyers under stress to pad timesheets, prepare 'dummy' bills which are never sent to the client and increase write-offs. Active monitoring of key performance indicators, as well as effective supervision at all levels – including supervision of partners – helps mitigate this risk.

AIRMIC, the Association of Insurance of Risk Managers, warned that the credit crunch may be a 'breeding ground for fraud'. *American Lawyer* magazine\*, reporting on the case of a senior partner in a global law firm charged with fraud, where the US government is also seeking forfeiture of a staggering \$2.4bn, commented: "For the lawyers involved, the outlines of the story aren't flattering. A kind reading of the facts suggests that at best they unknowingly enabled a vast fraud to be perpetrated." Much the same picture emerges in a number of major fraud investigations in which the writer is advising top 100 UK law firms. An additional feature in the American case, less common in the UK but a salutary warning nonetheless, is the comment that the firm's "eat-what-you-kill culture arguably led to lapses in judgment that, in the end, hurt the clients and the firm".

At a more mundane level, we have seen a significant increase in loan fraud, both residential and commercial mortgages, and many of the top 100 UK firms have been hit with substantial claims, both in value and number. Although at first sight it may seem like locking the stable door after the horse has bolted, there are two points to note. First, fraud may still be ongoing, so have you trained staff to be on the lookout, particularly noting the Law Society's Practice Note on Mortgage Fraud and implemented additional controls? Second, if it has already happened, great care is needed in managing the insurance, money laundering and professional issues.

Mortgage brokers, under pressure to find business to replace the evaporating standard mortgage market, are being encouraged to diversify. One example of this is equity release. These may be sold by people with inadequate experience and training. They are a riskier product: the writer has defended solicitors against thousands of claims relating to these, and even though specialists with vested interests may insist that the worst excesses of the 1990s have been effectively countered, there is enough evidence of disappointed 'investors' to put law firms on amber alert.

Another area of grave concern which has given rise to several claims is sharks who are buying houses off people in debt at a huge discount and renting them back to the seller at a rent which starts low but then increases significantly. Solicitors are already in the firing line for these claims.

Finally, don't forget that 'normal' risks continue unabated. Anti-money laundering is even more important in view of the fraud risks identified above, and the anniversary of the Money Laundering Regulations 2007 on 15 December 2008 is a timely reminder that firms should undertake a compliance audit and check training is up to date to ensure they can demonstrate compliance. The recent FSA fine on a financial advisory and asset management firm and its money laundering reporting officer for inadequate client due-diligence systems is a timely reminder that regulators will not be having a downturn in business. *FDLegal*

\* Target practice – 01/11/08



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