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90% of €500 euro notes are in the hands of organised crime according to SOCA – now withdrawn from sale in the UK.

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Money Laundering Reporting Officer fined

A second Money Laundering Reporting Officer (MLRO) has been fined by the Financial Services Authority. Although outside the legal sector, it is a salutary reminder for the legal profession for a number of reasons. Alpari (UK) Ltd was fined £140,000 and its MLRO Sudipto Chattopadhyay £14,000. Both fines were net of a 30 per cent discount for early settlement.

The FSA Final Orders reveal the following features –

- Failure to carry out risk assessments;
- Inadequate customer due diligence;
- Failure to monitor accounts diligently – particularly as they had non-face to face clients, many from high risk jurisdictions;
- Inadequate procedures for screening against sanctions lists and identifying politically exposed persons (PEPs).

Sanctions compliance is an area of weakness in the financial services sector, and it is also an area of weakness in law firms in our experience. The sanctions regime is absolute, not risk-based. See also reference to the JMLSG guidance in the following article.

The Final Order adds (at paragraph 4.12) that 'Alpari mistakenly believed that its electronic system checked against sanctions lists and checked for PEPs when it did not. This meant that no checks against the sanctions lists or for PEPs were carried out during the relevant period and Alpari was exposed to the risk that it might accept customers in these categories without being aware of this fact. There was also confusion at Alpari over the difference between sanctions and PEP checks.'

Note too that the firm had expanded its customer base significantly and had not developed its compliance in line with that growth. Expanding law firms would do well to take heed. For the Final Orders see www.fsa.gov.uk/pubs/final/alpari.pdf and www.fsa.gov.uk/pubs/final/chattopadhyay.pdf.

We have advised many leading law firms and smaller practices on compliance, audit of systems and our helpline (either subscription or pay-as-you-go) provides urgent advice on production orders and privilege issues. We can test staff awareness with Desktop, our online risk management diagnostic tool, and also provide training.

For advice on anti-money laundering compliance, systems, audit and training, contact:
Sue.Mawdsley@legalrisk.co.uk

Other Anti-Money Laundering news: Ireland, JMLSG, Bribery Act

Ireland has now enacted the provisions of the Third EU Directive. There will be a significant amount of work for Irish firms to do in order to comply. We have advised a number of leading Irish firms on AML and other compliance issues.

The Joint Money Laundering Steering Group, which provides AML guidance to the financial sector, has published a Part III to supplement its existing guidance. This will include certain existing material which for various reasons did not sit comfortably within Parts I or II, and some additional, new material. Unlike Parts I and II, JMLSG does not anticipate that the Part III Guidance (apart from the guidance on the Counter-Terrorism Act 2008, Schedule 7) will be formally approved by a Treasury Minister. See www.jmlsg.org.uk/content/1/c6/01/76/96/Part_III_text_CLEAN_May_2010.pdf

Continued

Other Anti-Money Laundering news (continued)...

Topics covered include Sanctions, and Directions under the Counter-Terrorism Act 2008, Schedule 7.

As predicted in our March 2010 issue the Bribery Act 2010 has been passed. It is expected to be in force in the autumn. The Ministry of Justice website explains that the Act will:

- provide a more effective legal framework to combat bribery in the public or private sectors;
- replace the fragmented and complex offences at common law and in the Prevention of Corruption Acts 1889-1916;
- create two general offences covering the offering, promising or giving of an advantage, and requesting, agreeing to receive or accepting of an advantage;
- create a discrete offence of bribery of a foreign public official;
- create a new offence of failure by a commercial organisation to prevent a bribe being paid for or on its behalf (it will be a defence if the organisation has adequate procedures in place to prevent bribery);
- require the Secretary of State to publish guidance about procedures that relevant commercial organisations can put in place to prevent bribery on their behalf;
- help tackle the threat that bribery poses to economic progress and development around the world.

The government guidance is expected to be lengthy and lacking in specifics. Meanwhile, the Financial Services Authority has published a paper, *Anti-bribery and corruption in commercial insurance broking* which may be of wider use than its title implies. www.fsa.gov.uk/pubs/anti_bribery.pdf. As the report comments, 'senior management awareness, involvement and responsibility are vital in ensuring adequate anti-bribery and corruption systems and controls are in place and that appropriate resources are allocated to mitigate identified risks.' Aviation and energy are perceived as high risk sectors.

Law firms will need to consider their own policies and training on bribery issues, as well as those of their clients.

For advice to Irish law firms and others, or for advice on other AML issues and anti-bribery and corruption, contact:
Sue.Mawdsley@legalrisk.co.uk

Quinn Insurance Limited and solvency of other insurers

We reported in the March 2010 Risk Update that Provisional Administrators had been appointed to Quinn Insurance Limited. This understandably caused consternation not only to the 2911 firms insured by them but also to the profession and other insurers.

Guidance from the Law Society on 15 April 2010 and the Solicitors Regulation Authority on 16 April 2010 indicated that this was not an 'insolvency event' for the purposes of the Solicitors' Indemnity Insurance Rules 2009, and that there was therefore no *regulatory* requirement on firms to take out fresh insurance; whether they wish to do so for their own peace of mind may be a separate issue, bearing in mind the possibility that claims made now, or during the six year run-off for firms ceasing practice before 1 October 2010, may take many years to evolve before any payment is required.

The situation is also a concern for firms undertaking high value litigation against insured defendants, particularly high value personal injury work where substantial payments may be due in the future, either under periodical payments orders or for provisional damages. We have been advising a number of law firms on issues arising out of these concerns. Suffice to say, the position is rather more complex than might be imagined depending on the home state of the insurer, the policyholder, the risk covered and the type of claim, and we have identified more serious concerns than those relating to Quinn.

While many have suggested that the SRA should impose rating criteria, they should not forget that the ratings agencies have hardly been immune from criticism in recent times, and another qualifying insurer, Independent, went into liquidation on 18 June 2001 with an A rating. "Why insurance companies fail," a working party report given at GIRO 2002 under the chairmanship of Roger Massey identified the value of ratings agencies, but also their limitations. By way of illustration, research by Standard and Poor's identified that for those companies that were rated 'A' in year one, on average 1.48% had failed by the end of year ten. Ten years may seem a long time, but it is material.

Market gossip may appear to be an indicator of impending problems. The Massey report identified that there is some anecdotal evidence that rumours of problems at an insurance or reinsurance company can be a first sign of the impending demise of the company. The report added that it is, however, important to recognise that, in an industry that relies on its reputation and its ability to make payments at some future date, the rumour itself can be a factor in the impairment of the company's viability.

Continued ...

Quinn Insurance Limited and solvency of other insurers (continued)...

The report evaluates causes of failure, including catastrophes, rapid expansion (closely linked with under-pricing), outsourcing and delegated management authority, over-reliance on reinsurance, under-reserving, unforeseen claims, fraud and reckless management, false reporting, and expansion into new areas. It can be an interesting exercise marking insurers against these criteria, but rather easier after the event. Of these, the report identifies under-reserving as perhaps the most significant. In the case of Quinn, the administrators' second report presented to the Irish High Court on 20 May 2010 revealed that an actuarial review had uncovered some €68m under-provision for liabilities in 2009, along with a €47m loss for the year to end of December 2009.

Who will be the next to collapse? The report advises that the sorts of questions to ask spring directly from the causes of failure:

- Who is expanding rapidly?
- Who is entering new areas?
- Who cedes very little premium to reinsurers?
- Who cedes a high proportion of their premiums to reinsurers?
- Who is run by a larger than life director who has a flamboyant lifestyle?

While it is improbable that we will see Solicitors Indemnity Fund rise from the ashes, there may be opportunities for larger firms to consider captive or mutual solutions and we are aware of some projects underway.

2010 will be a difficult renewal, particularly for small firms in our view, with a scramble for cover by nearly 3,000 firms who can ill afford a substantial increase, many of whom may have claims and other historical issues (including successor practice problems) limiting their access to the market, and heightened concerns about security.

However we are also aware of a number of large firms with some significant claims issues. They will doubtless obtain cover, but at a price. Firms which have had a significant fraud problem (in which we include fraud by clients, particularly multiple mortgage fraud), will need special attention from an early stage. We are assisting several firms in this category.

For legal and practical advice on insurance issues, including those relating to Quinn, coverage, and renewal, contact: Frank.Maher@legalrisk.co.uk

Outcomes-focused regulation

The Solicitors Regulation Authority has launched a dialogue with practitioners and consumers about coming changes to the regulation of the legal sector, with a series of roadshows and a consultation paper to which response are invited. The stated aim is that these changes will allow the freedom to innovate, at the same time as providing a strong focus on the quality of the services provided to clients.

The Smedley report, *'Review of the Regulation of Corporate Legal Work'*, www.legalregulationreview.com/corporatereview.html commented that –

'In many respects, this style of regulation requires more from the regulated community, while at the same time removing unnecessary and ineffective procedures. For example, if my recommendations in this report are accepted, the large corporate firms would have to accept a greater degree of involvement by the regulator in relation to their business systems. This is not always going to be welcome to a firm and, sometimes, the messages from the regulator will contain uncomfortable truths. It will require the firms themselves to step up to the mark and aim for higher benchmarks of performance in internal governance.'

For further information and the consultation paper, see www.sra.org.uk/freedominpractice/.

For advice on regulation, compliance and disciplinary matters contact: info@legalrisk.co.uk

Limiting liability

An accountant's contractual limit of liability of £1 million was upheld in **Dennard & Others v PricewaterhouseCoopers LLP** [2010] EWHC 812 (Ch), though the rather brief decision on the point is obiter, as the damages awarded were only £427,500.

www.bailii.org/ew/cases/EWHC/Ch/2010/812.html

We have advised on the terms limiting liability for ten top 100 UK firms, leading overseas firms and many other firms, and provided expert evidence on limiting liability for use in High Court proceedings.

For advice on limiting liability and for model terms contact: Frank.Maher@legalrisk.co.uk

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SRA – new disciplinary powers

From 1 June 2010, the SRA will have the power to impose a written rebuke and/or impose a fine of up to £2,000. For further details click here www.sra.org.uk/sra/news/sra-update/issue-13-rebukes-fines.page

Legal Risk LLP's Top 100 Survey



Our seventh annual Top 100 Professional Indemnity and Risk Management Survey 2010 has now been published and is available on www.legalrisk.co.uk/Pages/Resources.aspx?id=259.

This year's survey covers choice of insurer and broker and information on the size and makeup of firms' risk teams as usual, but also covers outsourcing.

The survey shows not only the choice of insurer but the mobility of firms and how it remains a price-sensitive purchase. Last year we noted that some firms had changed two or even three times since the open market began in 2000. None of this year's firms changing insurer had done so before.

With 9 per cent changing insurer – about average – although larger firms value the relationship with their insurers and the claims handling team that comes with it, it remains a price sensitive product, price being the only reason cited for change.

Since our first survey in 2004, the risk function in larger law firms has become well established with partner and senior personnel involvement, proper systems of management and control, audit committees and a far more corporate style of risk management. Client engagement procedures have become more sophisticated, driven partly by anti-money laundering legislation. We are also seeing overseas firms looking to the UK for a model in managing risk, which is mirrored by our increasingly international client base.

Limiting liability has become far more widespread, to the point that two years ago all respondents to the survey were limiting liability at least some of the time.

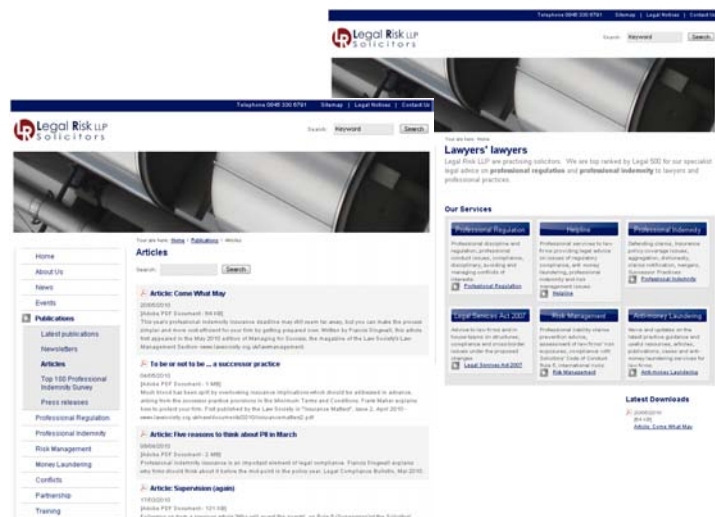
Articles

Recent articles added to our website cover –

- Professional indemnity renewal (2);
- Successor practices;
- Supervision.

For a full list see -

www.legalrisk.co.uk/Pages/Resources.aspx?id=237



This newsletter is a general guide. It is not a substitute for professional advice which takes account of your specific circumstances and any changes in the law and practice. Subjects covered change constantly and develop. No responsibility can be accepted by the firm or the author for any loss occasioned by any person acting or refraining from acting on the basis of this.

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