SPRING 2023

ESSENTIAL NEWS FOR LEGAL PROFESSIONALS

THE BRIEF

Increasing Risk and Regulation

cpm21
21st century professional management for lawyers

Welcome to the twelfth edition of the Brief.

In the last edition I wrote about the changes that the end of the Elizabethan Era would likely bring. I went on to say: "This new era will no doubt shape a new world to which the profession will have to adapt".

Charles is about to be crowned as King. He may find that he develops writer's cramp or "focal hand dystonia" as the medics would say. There are so many new pieces of legislation for him to sign into law. Much of the new legislation and consequent regulation has a profound effect on the way lawyers practice law. It seems there are now almost weekly changes that will affect firms and individual legal practitioners.

There is now so much to do before you even start the legal work for a client. The "day job" is overwhelmed by a sea of compliance requirements. If you get it wrong, you can face unlimited fines from the regulators and even lose your livelihood or indeed your liberty.

In this complex regulated world you can easily become lost, confused, unsure, perplexed and bewildered.

In this edition the team aims to help you journey through the labyrinth.

• Paul Jones kicks off by explaining how the working environment has changed and the importance of "flexible working" even before the new legislation receives Royal Assent later this year.

• Ian Hopkins then tells us about the new legislation empowering the SRA to impose far larger fines and the power of the SDT to impose unlimited fines. With the SRA now far more active in auditing firms for AML Compliance etc, this topic is becoming far more important in the Risk Management of an organisation (or individual) regulated by the SRA.

• Ian East then tells us about another piece of legislation which is having a major effect on legal work including legal aid work. It's the Sanctions and Anti-Money Laundering Act 2018 and the resultant requirement to comply with OFSI rules and regulations. He explains that Sanctions are wider in scope even than the expanded Money Laundering Regulations and will probably impact all legal practices in England and Wales. Ignore this article at your peril.

• Ian East then goes on in the following article to describe the effects of the Economic Crime (Transparency and Enforcement) Act 2022 that received Royal assent on 14 March 2022. If you hoped that was the end of the tidal wave of change then you will be disappointed to read about further legislation currently before Parliament which will have a significant impact on the legal sector including potentially giving the SRA itself unlimited fining powers.

Please visit our website to see how we might help you: www.cpm21.co.uk. We, at cpm21, are constantly monitoring the changing regulatory map so we can assist firms to navigate the regulatory labyrinth and reduce risk.

As always, we hope you find this edition practical and useful. We would welcome your feedback.

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21st century professional management for lawyers

When not being flexible might hurt...

While the Covid 19 Pandemic may have gone away, its effects linger on when it comes to employee working patterns in the UK.

Working from home became the new normal for many, including legal firms and their employees. Those legal firms that didn't have remote access to their case management systems and may have never really understood why it was necessary, found themselves rushing to their IT support and case management system providers to make it possible for their fee earners to provide legal services to those that continued to want or need them during the multiple lockdowns.

And that, coupled with other measures such as furlough payments for areas which couldn't be serviced any other way, kept legal businesses going.

Of course, that all ended as the once in a lifetime (hopefully) event came to an end. But not for all legal firms and working from home.

As other industries found, there was a reluctance for all personnel to want to come back to the office. This working from home had awakened a craving for work life balance that was once a dream, but was now a reality. It was possible, so why couldn't legal firm staff do it all the time if they so wished?

This has been met with a mixed reaction, with some firms demanding their staff return to the office, while others have softened attitudes and allowed "hybrid" working, where employees spend some time in the office, and some time working from home. And so, to the title of this article – when not being flexible might hurt.

Well, that's fairly simple. In the time since the Pandemic, recruitment in the legal market has become a battlefield, and it's

> Understanding the aspirations of the partners as owners of the business and how they see the future development of their firm is key to any successful business plan.

the big guns who are benefitting. Big guns is a reference to the larger law firms, who have discovered that, as well as being able to offer competitive salaries and benefits packages to potential recruits, they can now also offer remote working.

"We'll pay you more, we'll give you a great benefits package, and you can work from the comfort of your own home."

What a recruitment weapon. Imagine being a fee earner living in a rural location which you love, but not being happy with your salary, suddenly getting offered a city firm salary without the need for travelling or moving to the city?

For firms not offering hybrid working, this could be a major problem across the board, not just for fee earners, but for trainees who have completed their training.

Whether firms like it or not, they at least need to consider hybrid working and being flexible, because there is even more change on the horizon with the government set to introduce changes to "flexible working."

In this case, flexible working doesn't just mean a combination of working from home and in the office – it can mean employees making use of job-sharing, flexitime, and working compressed, annualised, or staggered hours.

And new government legislation is intended to allow the employee to have the right to request flexible working from day one of their employment.

The intention by the government is to allow employees to have greater say in when, where and how they work, leading to a better work life balance, particularly for those with commitments or responsibilities such as caring for vulnerable people or children.

If an employee makes a request under this new legislation, which the employer doesn't believe they can accommodate, they will be required to discuss alternative options before such a request can be rejected.

It is unclear exactly when this legislation will be introduced in 2023, so firms should start thinking about how they might have to implement flexible working in their organisations, as there will inevitably be those employees who request it.

So, back to the title of this article – firms need to consider flexibility at all levels to compete with others, and to ensure they are prepared for the new rules.

Because not being flexible could indeed hurt.

Paul Jones
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Update on the SRA's Approach to Fines and Referral to the SDT

The Solicitors Regulation Authority (SRA) investigates complaints against solicitors and law firms. If it finds evidence of professional misconduct, the SRA can act, including fining individuals and firms.

In some instances, particularly if the SRA's view is that the misconduct is so serious it requires a solicitor to be prevented from practising, it will refer cases to be heard by the Solicitors Disciplinary Tribunal (SDT). Only the SDT can suspend and strike - off solicitors, while it also has unlimited fining powers.

In July 2022, the Ministry of Justice increased the SRA's fining limit for solicitors and traditional law firms from £2,000 to £25,000. The SRA can now act in more cases without the need to refer them to the SDT.

For alternative business structures (ABS), the SRA can fine up to a limit of £50 million for individuals and £250 million for firms - a significant difference between a traditional law firm and an ABS and possible explanation as to why more traditional law firms don't take advantage of the ABS model.

With the increased limit on issuing fines since July 2022, the SRA and SDT have developed a shared expectation of the type of cases that would be referred to the SDT by the SRA, and those that the SRA alone would deal with.

It should be noted however that there have recently been further developments in relation to the SRA's fining limit. The Economic Crime and Corporate Transparency Bill is proceeding through Parliament, which will give the SRA unlimited fining powers in relation to economic crime. It's likely that the SRA and SDT will need to review and update their approach and understanding once the Bill comes into force.

The SRA's approach to referring to the SDT

The SRA will apply its new fining powers to all cases where it considers that a fine of between £2,000 and £25,000 is appropriate.

The SRA and SDT recognise that it is a matter for the SRA to determine which matters to bring before the SDT. The SDT has no remit until a case is lodged with it for issue.

Cases that will generally be referred to the SDT

The SDT will continue to hear the most serious cases of individual professional misconduct. The likely result in such cases, if allegations are proven, would be a sanction or strike off that would stop an individual from practising.

The SDT will also continue to deal with cases against firms where the likely financial penalty exceeds £25,000.

The motivation of the regulated individual or law firm will be relevant and whether there is a serious recklessness or willful regard of regulatory requirements. The impact of the misconduct will also be an important consideration.

Cases that should typically be referred to the SDT

The SRA and SDT recognise that there are also cases that will be best heard by the SDT, irrespective of whether the SRA has relevant sanctioning powers. Examples of such cases may involve the following.

- Cases that are of high interest or that involve a novel point of law.
- Cases involving allegations of sexual misconduct, racism, bullying, harassment, or other counter-inclusive misconduct and/or conduct that targets an individual because of a protected characteristic.
- A failure by a law firm to take appropriate steps to protect an employee from counter-inclusive conduct, or to ensure a safe working environment (for example, where there is evidence of pervasive toxic culture)
- A serious failure by a law firm to comply with the regulatory framework resulting in harm to individuals (either clients or employees)
- Cases involving significant and/or manifest incompetence or recklessness, including where there has been serious misconduct by others.
- Cases involving more than one respondent, where some or all the respondents contest the allegations.
- Cases involving misappropriation of client money, and/or other serious misuse of client money which may or may not involve noncompliance with legislative requirements such as anti-money laundering requirements.
- Cases that should typically be referred to the SDT might also include cases where there have been repeated failures to correct poor practices, despite warnings from the SRA or others.

Matters no longer referred to the SDT

The SRA's increased fining limit will mean that it will now be able to deal with cases at a higher level of seriousness than previously. For example, these cases might involve a breach of the SRA's Accounts Rules with personal culpability, but with no deliberate intention to misappropriate money or personal gain.

How will the SRA approach its increased fining limit?

Following a widespread public consultation exercise involving over 7,500 participants, the SRA confirmed the details for how they will levy financial penalties to law firms and solicitors via news releases in February and March 2023.

The reforms which will come into effect later in the year will see.

The introduction of a fixed penalty regime for lower-level misconduct by individuals and firms. A further consultation will be held this year on the details of how a new fixed penalty regime would work.

Future fines for both firms and individuals linked directly to bandings based on percentages of income/turnover taking the financial means of individuals into account when setting fines.

The new fining bands will enable different levels of fines to be issued to a low - earning junior solicitor compared to a senior equity partner for similar offences.

For cases involving sexual misconduct, discrimination or any form of harassment, financial penalties will only be considered in exceptional circumstances, with restrictions on practice, suspension or strike off the more appropriate sanction.

A pilot on the use of personal impact statements for cases involving sexual misconduct, discrimination, or any form of harassment.

The SRA believes the changes will help cases be resolved more quickly, saving time, costs, and stress for all involved, all of which are welcomed.

However, a key area of concern identified by the consultation is around a lack of alignment between the approach of the SRA and the SDT, particularly that the SDT regime provides greater transparency and independence.

The SRA has accepted the above point and as a result will look to develop their processes to increase transparency and carry out further work to explain the checks and balances in place in their processes, which is encouraging.

Whilst most solicitors and law firms meet the standards the SRA expects, the SRA has made it clear that they will "step in" where they see evidence of poor regulatory practice.

It's clear that the SRA does not confine regulatory practice solely to adherence with the Accounts Rules or AML regulations - its far wider than that and extends to all aspects of a law firm that impact upon the welfare of its employees, including for example the firm's culture.

With the SRA's fining capability now increased to £25,000 for traditional law firms and £250 million for ABS, Managing Partners, COLPS, COFAs and anyone involved in managing people in a law firm will need to ensure that good regulatory practice is at the heart of their firm's approach to business, and that everyone in the firm, irrespective of seniority, is required to sign up to, with a zero tolerance approach for offenders.

Ian Hopkins

Sanctions

The issue of sanctions is proving to be an ongoing headache for many firms of solicitors. For firms that may have previously escaped the most onerous requirements of AML compliance due to their areas of practice this is likely to be a completely new type of compliance requirement. For firms that already operate within the scope of the AML regulations it presents additional compliance obligations due to the fast moving, and ever changing, nature of the sanctions to be considered.

What are Sanctions?

The Sanctions and Anti-Money Laundering Act 2018 provides the main legal basis for the UK to impose, update and lift sanctions. Sanctions are restrictive measures imposed by the government to achieve a specific foreign policy or national security objective. A breach of UK sanctions is a criminal offence and is punishable by a fine and/or imprisonment. There are various types of sanctions, and sanctions measures that can be imposed. These include:

Financial sanctions, including asset freezes - administered by the Office of Financial Sanctions Implementation ("OFSI");

Trade sanctions, including arms embargoes and other trade restrictions - administered by the Department for International Trade (DIT);

Immigration sanctions, barring entry to the country - administered by the Home Office; and

Transport sanctions (divided into aircraft and shipping sanctions), including de-registering or controlling the movement of aircraft and ships, often preventing them from docking in UK ports or landing in UK airports - administered by the Department for Transport (DfT).

Sanctioned individuals, entities, planes, or ships are referred to as 'designated persons.' Sanctions generally apply to designated persons but may in some circumstances apply to whole jurisdictions. An example of this is The Russia (Sanctions) (EU Exit) (Amendment) (No. 14) Regulations 2022 introduced in July 2022. This legislation made it illegal to provide some services to clients in Russia.

Sanctions that apply to whole jurisdictions are, however, unusual. Normally sanctions relate to lists of individuals, entities, ships, or planes. These lists are often titled as being related to a given jurisdiction. The sanctions will then apply to the jurisdiction, e.g., Russia, but that does not mean that all Russian people and entities are subject to sanctions. It also does not mean that sanctions regimes cannot relate to individuals who live in, or are from, the UK. This has been seen in sanctions under the Islamic State/ Da'esh regime which have resulted in a number of UK nationals becoming explicitly named on the sanctions list, and therefore becoming designated persons.

The SRA

The SRA have issued sanctions guidance to assist firms with their compliance obligations. The main issue for firms is, however, implementing this guidance. A key consideration with this is knowing if clients, or the beneficial owners of the clients, are subject to sanctions. For firms that operate outside the scope of the AML regulations that can present additional problems as they may not have systems in place to help with this. This particularly applies if firms are not using electronic identification & verification (EID&V) systems. Normally these systems will identify politically exposed persons (PEPs), and those subject to sanctions, thereby putting the firm on notice so that they can take appropriate action.

For firms that do not make use of EID&V, manual checks can be carried out using the OFSI screening platform. This can be somewhat labour intensive, but there is a gleam of hope as the SRA has stated that they, "expect firms we regulate to take a proportionate effort to prevent unintentional or accidental breaches of the sanctions." Guidance issued by the Law Society also states, "You may apply a risk-based approach to setting up a system that checks your clients against the sanctions lists." This risk-based approach appears to offer some flexibility provided that firms can show that they are taking their obligations seriously.

Firms that provide legal aid services do not escape from these requirements. The Law Society guidance in relation to sanctions states, "You'd also need a licence from OFSI to use legal aid payments for the benefit of a person on the list." This position has also been confirmed by the SRA.

On 28 November 2022, the SRA issued its most recent guidance on the financial sanctions regime which includes details of how they expect firms to deal with their compliance obligations. The guidance imposes new requirements on firms and makes it clear that this also extends to work that falls outside the scope of the Money Laundering Regulations. These new requirements are along similar lines to those for anti-money laundering compliance, and include requirements for risk assessments and policies, controls, and procedures (PCPs).

The new guidance says:

"For firms with an AML compliance regime, a way of achieving a good standard of sanctions controls might be identifying and verifying all clients (whether in scope of AML or not) to the standard required by the money laundering regulations, and then checking against the sanctions list."

It also refers to various requirements of an effective sanctions compliance regime including:

- An assessment of the sanctions risks to which the firm may be exposed;
- A written and implemented set of policies, controls, and procedures;
- A record of your assessment of sanctions risk for each client and/or matter;
- A documented and implemented policy and procedure;
- Training on the sanctions regime and related internal compliance procedures;
- Internal and external reporting procedures; and
- A form of regular (for example annually) independent audit.

The parallels with the AML compliance regime are therefore clearly apparent. These obligations are now in place and no doubt the SRA will be checking for compliance in a similar way that it does for compliance with the AML requirements.

Proliferation Financing (PF)

The recently updated Legal Sector Affinity Group (LSAG) AML guidance for the legal sector includes guidance in relation to PF. This guidance relates to the changes introduced by the Money Laundering and Terrorist Financing (Amendment) (No. 2) Regulations 2022 from 1 April 2023.

PF is broadly defined in regulation 16A(9) of the Money Laundering Regulations 2017 as:

"the act of providing funds or financial services for use, in whole or in part, in the manufacture, acquisition, development, export, trans-shipment, brokering, transport, transfer, stockpiling of, or otherwise in connection with the possession or use of, chemical, biological, radiological or nuclear weapons, including the provision of funds or financial services in connection with the means of delivery of such weapons and other CBRN-related goods (technology and dual-use goods used for non-legitimate purposes in connection with the matters referred to in the definition of proliferation financing above) and technology (including dual-use technology - i.e. it could be used for either civil or military purposes), in contravention of a relevant financial sanctions obligation."

The amendments to MLR 2027 require all firms to carry out a proliferation financing risk assessment.

This means that firms will need to assess the risk of being used to facilitate the proliferation of nuclear, chemical, biological and radiological weapons.

The SRA considers that the overall risk relating to PF for the legal profession is low. Most firms will therefore be able to assess their exposure to this risk within their existing firm/practice wide risk assessment. To assist with this they refer to the National Proliferation Risk Assessment and their own Sectoral Risk Assessment.

Some services are regarded as being at a higher risk of exposure to proliferation financing. The SRA expect to see a more detailed proliferation financing risk assessment from firms working in the following areas:

- Trade finance;
- Commercial contracts;
- Manufacturing, particularly in relation to dual-use goods;
- Commodities – particularly mined metals and chemicals;
- Shipping/maritime
- Military/defence
- Aviation

Guidance in relation to conducting a proliferation financing risk assessment is included in the updated LSAG guidance 2023.

Ian East

The Economic Crime and Corporate Transparency Bill

Since the Russian invasion of Ukraine on 24 February 2022 the UK legal sector has had a raft of new regulatory requirements and guidance to comply with. In part this was brought in by the Economic Crime (Transparency and Enforcement) Act 2022 (the "ECTE Act") that received Royal assent on 14 March 2022. The ECTE Act:

Allowed the government to move faster and harder when imposing sanctions;

Created a Register of Overseas Entities (ROE) to help crack down on foreign criminals using UK property to launder money; and

Reformed and strengthened the UK's Unexplained Wealth Order regime to better support law enforcement investigations.

Following on from this the government's Economic Crime and Corporate Transparency Bill ("the Bill") has had its second reading in the House of Lords and is currently at the committee stage. The Bill is in intended to deliver reforms in relation to tackling economic crime and improve the transparency of corporate entities.

The aims of the Bill are to deliver:

- Reforms to Companies House.
- Reforms to prevent the abuse of limited partnerships.
- Additional powers to seize and recover suspected criminal cryptoassets.
- Reforms to give businesses more confidence to share information to tackle money laundering and other economic crime.
- New intelligence gathering powers for law enforcement.
- The reduction of burdens on business.

Proposed Changes

Proposed changes to Companies House include:

- Introducing identity verification for all new and existing registered company directors, People with Significant Control (PSCs), and those delivering documents to the Registrar. It is intended that this will improve the accuracy of data held to assist the making of appropriate business decisions and with law enforcement investigations.
- Improving the financial information on the register so that the register is more reliable, complete, and accurate.
- Making Companies House a custodian of more reliable data relating to companies and other UK registered entities e.g., limited liability partnerships (LLPs) and limited partnerships (LPs).
- Broadening its powers relating to overseeing company creation.
- Powers to check, remove or decline information submitted to, or on, the register.

Furter proposed changes include:

- Amendments to the register of overseas entities (ROE) to maintain consistency with changes to the Companies Act 2006.
- Some exemptions from the principal money laundering offences to reduce reporting requirements for businesses. This in part will be achieved by increasing the types of situation in which businesses can deal with clients' property without having to first submit a Defence Against Money Laundering (DAML) SAR.
- New powers for law enforcement to obtain information to tackle money laundering and terrorist financing.
- The enablement of businesses in certain sectors to share information more effectively to prevent and detect economic crime. It is proposed that this will be achieved by reducing or removing civil liability for breaches of confidentiality for firms that share information to prevent economic crime.
- Adding a regulatory objective to the Legal Services Act 2007.
- Creating additional powers to allow law enforcement to quickly and easily seize and recover cryptoassets which are the proceeds of crime, or are associated with activities such as money laundering, fraud, and ransomware attacks.

SRA Fining Powers

The proposed change that in many ways may be of most concern and significance to the legal sector is, however, the removal of the statutory fining limit for the Solicitors Regulation Authority (SRA). This would allow the SRA to set its own limits on financial penalties imposed for economic crime disciplinary matters.§

The Law Society issued guidance on the Bill on 9 February 2023. This guidance states that it welcomes the Bill and, "its intention of supporting the fight against illicit finance." It does, however, raise some concerns including those in relation to the proposed increase in the SRA's fining powers. In part this concern is due to the fact that this change would follow on from the recent substantial increase in the SRA's fining powers from £2,000 to £25,000.

When the proposals contained within the Bill take effect, they will impact directly on the compliance requirements and activities of both firms within the legal sector and organisations of all sizes. This is therefore an area that will require close ongoing monitoring by all concerned.

Ian East

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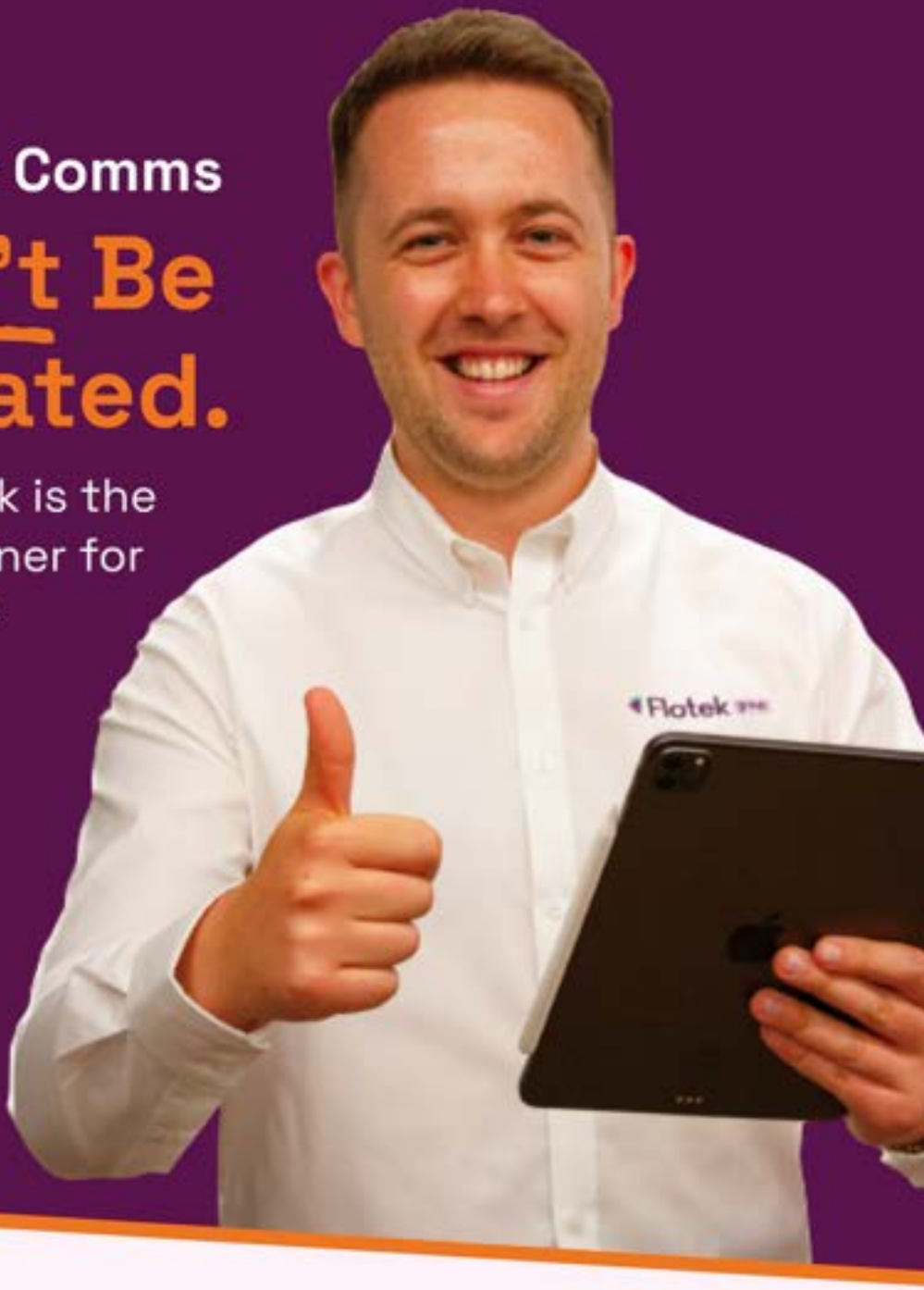

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