

Policy Risk-based regulation of lawyers' trust accounts

Purpose	1.1	The purpose of this policy is to establish a framework for a risk based approach to the regulation of lawyers' trust accounts, including the conducting of trust account investigations.
Introduction	2.1	<p>The conduct of legal business often requires the safe, reliable transfer of money; this is typically done through a law practice trust account. It is vital to maintain the integrity of law practices' trust accounts because consumers of legal services are entitled to rely on the absolute safety of their money. Lawyers who are entitled to receive trust money have a fiduciary duty to the person on whose behalf they hold it and the consequences of breaching their fiduciary duty can be that criminal or disciplinary action is taken.</p> <p>In previous years there has been a focus on ensuring that every law firm in Victoria with a trust account was the subject of a trust account investigation every five years. This approach has continued even as the number of lawyers and law firms has increased in Victoria without a correlating rise in overall resources. The Victorian Legal Services Board + Commissioner (VLSB+C) has decided to move away from this approach as it is resource intensive and does not direct investigations to where non-compliance has a higher risk of harm. This approach has been fully supported by the Law Institute of Victoria (LIV) who have also been actively engaged in developing the tools needed for this risk based approach.</p> <p>The VLSB+C aims to be a regulator that is pro-active, not solely re-active, that sets its own agenda and encourages compliance amongst a largely compliant profession.</p> <p>Numerous state and federal regulators have moved, or are moving to a risk-based regulatory model. This approach involves developing decision-making frameworks and procedures which prioritise regulatory activities and deploy resources, principally relating to investigation and enforcement, based on an assessment of the risks that regulated firms pose to the regulator's objectives.</p> <p>Risk-based regulation is about finding the right level of oversight to deal with the most important risks. Taking a risk-based approach to trust account investigations will enable the VLSB+C to:</p> <ul style="list-style-type: none"> • minimise harm to consumers of legal services by anticipating areas of practice, and categories of lawyers, where there is the highest risk of harm and working to address those risks; and • make choices based on priority, risk and urgency rather than attempting to check compliance across the whole of the legal profession in the same way.
Legislative Framework	3.1	<p>Authority to receive trust money is only given to a principal or employee of a law practice if that person attends the prescribed trust account course and passes the assessment and where the VLSB+C are satisfied as to that person's suitability.</p> <p>The VLSB+C on its own behalf or by external investigators (including the LIV) can investigate the affairs of law practices. The purpose is to ascertain whether a law practice has complied with the regulatory requirements and to detect and prevent fraud or defalcation. These powers extend to requiring a law practice to provide access to the trust records, or give information about the affairs of the practice.</p>

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What is *risk based regulation* in the context of this policy?

4.1

Risk based regulation in the context of this policy is the probability of a breach of the rules or regulations occurring combined with the impact of it happening. It is a shift away from focusing exclusively on a breach of the rules to focusing on areas of risk

Some risk is tolerable, some is not. Together with the LIV we have considered each of the various trust accounting and professional rules and identified them as high, medium or low risk of harm to consumers of legal services if breached. We include in our consideration factors such as: the frequency of the breach, over what period it has occurred, the amount of money involved, etc.

This allows us to determine where the line of acceptable risk is. We then look at what response is appropriate to each type of risk - what is the appropriate nature and intensity of enforcement.

This approach reduces the regulatory burden for lawyers and law firms who are compliant with their obligations.

A risk based approach lends itself to being adaptable to address emerging risks that arise from time to time. There is a clear driver to prevent (or at least minimise) fraud, which can have a devastating impact on members of the public as well as on claims against the Fidelity Fund.

While the VLSB+C will focus on targeted trust account investigations of lawyers and law firms that fall within a risk group (as identified from time to time), all firms may be the subject of a routine or re-active investigation at any time. A risk based approach is used in conjunction with re-active regulation focused on information received (for example, from complaints or other intelligence).

Additionally, traditional methods of regulation by random selection are also validly utilised as an option.

It should also be noted that all law practices must have their trust records externally examined annually by a suitably qualified person and that report must be submitted to the VLSB+C. While there is always some risk that a serious breach of the trust rules will occur outside of the various protections in place, this is a risk that also exists under a system that attempts to check all members for compliance, as every single member of the profession cannot be under constant surveillance.

Guidelines

5.1

What are the risks to consumers of poor or fraudulent trust accounting practices?

Fraudulent trust accounting practice is criminal behavior and can lead to significant disruption and loss for any member of the public affected. It can also lead to claims for compensation from the Fidelity Fund.

Poor trust accounting practices, for instance where a lawyer handles trust money without proper authority, can cause disruption and uncertainty to consumers of legal services.

Both can lead to a loss of confidence in the legal profession.

Guidelines as a "how to" guide to staff to give further particulars about how to apply this policy will be developed.

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5.2 Identifying the 'risky' practitioner?

In light of the risks to consumers of fraudulent and poor trust accounting practices, the VLSB+C will identify high risk lawyers and law firms in collaboration with the LIV, based on our joint expertise and using the following data and analysis:

- the results of analysis of ten years of VLSB+C complaints data conducted by the University of Melbourne
- data received from External Examiners who examine practices annually and report their findings to the VLSB+C
- other emerging risks; for example there has been a trend of inexperienced lawyers who have not being able to secure employment setting up their own law practices. These lawyers and therefore their practices are considered high risk because they often do not have sufficient business experience to properly manage a practice

Data analysis being done by the University of Melbourne for the VLSB+C provides independent research to better understand the nature of complaints received and the characteristics of the lawyer subject to complaints. This data assists the VLSB+C in guiding its risk based approach by identifying the characteristics of lawyers who attract complaints and those who do not in order to identify factors that increase a lawyer's risk of exposing their clients to harm or being subject to a complaint.

Decisions identifying high risk lawyers will be made having regard to the *Charter of Human Rights and Responsibilities Act 2006* thereby ensuring that all decision making is undertaken in a manner that is compatible with human rights.

5.3 Assessing the risk

All lawyers and law firms within the identified high risk groups will be required to undertake a one off risk assessment. The VLSB+C may choose not to conduct a risk assessment if the lawyer/law firm has recently been the subject of a trust account investigation, that is within approximately the preceding 18 months.

5.4 Example

Assessing the risk with the Trust Account Investigation report or desk top audit

The outcomes of the risk assessment or desk top audit, or any further report received are reviewed and assessed together with other information collected by the VLSB+C in its data bases. This will include any prior complaint, disciplinary action, fidelity fund claim, suitability consideration and/or trust account compliance history. Lawyers with significant histories, in terms of seriousness or volume of issues, will be subjected to a more serious regulatory response.

For example, a lawyer with no prior disciplinary history who is shown to have failed to complete reconciliations for three months may be reminded in writing of the outcome of the assessment, but does not need to provide a response to the VLSB+C. Another lawyer committing the same breach but with a previous record of non-compliance or delays in completing legal work may be reminded in writing of the outcome of the assessment, including any breaches and requested to satisfy the VLSB+C that remedial action has been taken.