ONBOARDING CLIENTS: Know Your Client & Risk Assessment for Professional Practices

While claims arise at a variety of points in a professional engagement, the single most important point of risk control occurs before you undertake any significant work on the matter. Your risk assessment and onboarding processes determine which clients are taken on, and what work your firm undertakes for them.

Risk Appetite Framework

Each year, in your professional indemnity proposal form, you provide a host of detail about the nature of the work your firm has undertaken in the last year. You should also be able to evidence how that work fits with both the experience of your fee-earners and the strategic direction of the firm.

A clear business strategy is important in determining the staff skills and experience you require, and the systems and processes required to support them deliver your services. This, along with your/your firm's approach to risk, should determine your Risk Appetite Statement. UK-based professional firms have been required to 'identify and assess the risks of money laundering and terrorist financing to which [the] business is subject', under Regulation 18 of the Money Laundering, Terrorist Financing and Transfer of Fund (Information on the Payer) Regulations 2017. Your Risk Appetite Statement has a different purpose, but the two documents should tie in together, and be aligned, and may cross refer.

The type of work taken on needs to be within the skillset of the staff you have, unless you have an arrangement in place to outsource complex elements (and that has its own risks). Just because a fee-earner has experience in a particular area does not necessarily mean that it is an area that you want to be undertaking, as a business.

As part of your strategic decision-making, you should be considering, and documenting:

> the broad areas of work in which you wish the business to operate – alongside an assessment of the respective risk profile of each area of work

Many firms, in their onboarding risk assessment process, are under the misapprehension that because work is of a common type, it is 'low risk'. Understanding the general claims-risk exposure of a particular work-type is a valuable first step in your strategic thinking, not a retrospective add-on.

> the types of work within each broad area that are within and outside your appetite.

This should involve consideration of a number of factors, including:

- the potential quantum of a catastrophic claim, should one arise (bearing in mind that neither the fees earned, nor the direct financial values involved in a matter necessarily correlate to the potential claim exposure)
- whether taking on the work would require an increase in your PII limit of indemnity, or otherwise adversely impact your PII premium
- level of complexity/risk of scope creep into additional areas outside of your expertise
- availability of suitable expertise and capacity to conduct and adequately supervise the work.

Your risk appetite is likely to change over time, as the firm evolves, and the market changes around it – so this should be revisited annually, or more often as required. Unspoken frameworks are much more likely to be forgotten or ignored, even by the person who formulates them. Simply by documenting your work-type risk appetite, and sharing it across the firm, you are reinforcing important messaging, and making it more likely to be engrained in the way the firm operates. Better still, use it as a tool, by building it into your matter acceptance processes.

Defining your risk appetite provides the starting point for an evaluation of risk controls, and also, as a cross-check on your public messaging (website content, articles, messaging to any introducers) to ensure that you are not inadvertently attracting work requests that were never within your appetite.

Client & Matter Risk Assessment

Your risk appetite needs to be embodied in a living process. If there is a single person in the firm through whom all potential new instructions must pass to be approved, the process may not need to be very involved at all, but it is still highly advisable that a record is kept evidencing the due diligence undertaken, and the factors considered in making the determination. From an insurer point of view, it is very reassuring when a firm can 'show its workings' in this manner. If the decision to approve a client or matter is delegated further down the chain to a wider number of people, the process needs to be that bit more evolved and formalised.

You should undertake a written risk assessment on each new client and matter/retainer particularly where the matter is non-repetitive. All too often, firms think of risk assessment *only* in terms of client identity verification or anti-money-laundering (AML), but they both offer too narrow a view of risk. Client and matter risks go far beyond many conventional 'know your client' (KYC) checks.

There is no 'one best way' to risk assess, but it should incorporate:

> Client Risk Assessment

This should include wider client due diligence risk factors and 'red flags' including location, 'fit' with the transaction (does it 'add up'?), capacity or other vulnerabilities, signs of being a 'difficult' client, hidden agendas, ability and willingness to pay.

> Matter Risk Assessment

In addition to KYC/AML risks, this should consider factors including:

- proximate or high-risk time-limits
- fit with risk appetite factors, including potential worst-case quantum of a claim and the likelihood of (unwanted) complexities (client attitude also matters here).
- availability of suitable staff, including supervisor time (considering existing work levels)
- likely earnings vs risk/time incurred
- matter area specific risk criteria

Good practice tips & things to avoid

> **Risk-assess the client and matter separately.** The same form can be used for both purposes but they should be considered independently. That is not to say that the two should not be reviewed in tandem, as sometimes the two can come together to have a multiplying effect such as having a difficult client who doesn't commit to things in writing (client risk) on a business deal subject to last minute negotiations (matter risk).

> **Do not default matters to low risk** (this is particularly a problem in electronic matter risk assessments). As a minimum, do not provide any default assessment. Alternatively pre-set a default by work-type, based on your own assessment of the inherent work-type risk, or default to a higher risk level that requires sign-off – so that it requires the fee earner to actively determine that a particular matter is lower risk.

> **Do not leave your fee earners with a completely blank canvas for identifying risk factors.** Free text space is good because the fee earner needs to document their thinking, but, as a minimum, you should provide them with some generic risk headings, with examples.

> **List specific 'red flag' risk issues for core work areas,** so that the form (or fields in your CMS) prompts consideration of those, while also allowing space for free text description of risk issues and/or mitigating factors which may influence the overall risk score.

The higher the risk score, or the more high-risk flags that are present, the more important it is that a senior member(s) of the management team sign-off on the new instruction before it progresses. Ideally, the identification of red-flag issues should force a senior review prior to the matter being accepted, even if the matter is otherwise 'low risk'.

> **Build in key stage reviews of your risk assessment**. Risk assessments should be re-evaluated:

- if instructions/scope change
- if important new facts emerge
- prior to matter completion, and at other key stages (this will vary according to matter type)
- if a supervisory review indicates that there is a need to review the risk.

Essentially though, risk awareness and ongoing monitoring is an essential part of risk management because any communication could bring with it a change in the risk profile of matter risk, client risk, or both.

> **Client risk assessments should be reviewed and updated with each new piece of work.** This is important because the risk profile of the client may change over time (e.g., new owners of a company or reduced ability to pay) and because you should be looking out for new instructions that do not fit the profile of the client and are not consistent with previous work which you have undertaken for the client. Some claims we see are due to business stakeholders developing different views and objectives over time. Unreconciled and unclear instructions can be both risky and stressful.

QBE has produced a template Client & Matter Risk Assessment which could form a basis for a review of your own existing risk assessment processes. See our Resources section at the end of this guidance.

Issues in KYC Risk Assessment

All professional firms subject to KYC/AML regulation face a range of additional challenges in recent years as regulators further tighten their compliance and reporting requirements in this regard.

Questions to ask yourself:

> **Do you have an up-to-date business-wide KYC/AML risk assessment?** Is it more than a copy and paste job from a provided template? Has it been updated in the last 12 months?

> **Have you used your KYC/AML Risk Assessment to meaningfully inform your AML policies, controls and procedures?** Again, are these more than simply copied templates – if reviewing them would your regulator see clear evidence that these were considered and relevant to your business?

> **Have you circulated your KYC/AML Risk Assessment amongst fee-earners in your business** and do you check that the client and matter risk assessments are consistent with it?

> **Have you undertaken an independent audit (to check that your KYC/AML policies and procedures are appropriate, effective and being properly followed) in the last 12 months?** Was it undertaken by an external consultant, or someone with suitable expertise in the firm who is independent of the AML processes management?

> **Have you documented any action points as a result of the audit**, and are they being followed up?

Digital ID Standard

The majority of firms are using electronic AML systems as standard now to assist with client due diligence. With the advent of the Digital ID standard (as used by the UK Land Registry) there is even more incentive to use the more advanced AML/ID check services, which include live-captured photography or video identity verification.

What to look for in your electronic ID/AML provider

i. **Does the system meet the Digital ID standard?**

ii. **Are multiple data sources used in the verification process?**

The more sources of reliable data used by a system, the more accurate it is likely to be. A mix of positive data (where specifics such as name, date of birth, address etc. are captured) and negative data (such as fraud incidents) will provide a more comprehensive assessment.

iii. **Is the data regularly checked/updated and checked**?

It is important that information such as permanent address and credit history is updated regularly. Integrity of data is equally important, and it should be clear what checks are performed on data integrity, and the outcomes of such checks. Ask your supplier or potential supplier if it is not a clearly evident part of the system specification.

iv. **Does the system facilitate updates of your own AML assessment**?

The recent war in Ukraine and resulting fast changing sanctions situation points up another important part of your AML checks – as with other risk assessment checks, this is not a one-off check at the start of a matter. Many of the electronic ID check providers allow for ongoing updates to the checks, which could pick up updates in PEPs, sanctions, connected parties, and potentially even source of funds issues. It would be wise to re-run such checks, particularly for transactions involving complex corporate structures, or clients with international connections.

KYC/AML Conclusions

The nature of the AML assessment that you undertake will depend on the risk factors relevant to a particular client or matter. Remember that just because you have AML assessed an existing client before does not mean that they do not require a fresh, and different level of assessment on a new matter.

It remains important that electronic checks are not seen as a panacea, and do not result in fee-earners placing full reliance on an ‘electronic acceptance’ – as we continue to see examples of technical passes enabling a transaction to proceed when other red flags were present and should have alerted the fee earners/MLRO to a high risk of fraud. Always look at the whole risk picture – which is another good reason to ensure that your wider client and vetting processes are equally robust. In addition, if an electronic check indicates a concern, you should document your follow-up of that concern. Additionally, make use of adverse media checks to inform your risk assessment.

Consider and evaluate your own client identification and risk assessment needs first and foremost, and do not simply conclude that any 'off the peg' product will be appropriate or sufficient in all cases. Remember it is you who will have to demonstrate that you took all reasonable steps to satisfy yourself the client is who they purport to be.

Related resources available from QBE

QBE has a range of templates, all of which are easily accessible by logging into QRisk (https://qrisk.qbe.com) including the following

- WORK TYPE RISK APPETITE FRAMEWORK TEMPLATE
- CLIENT & MATTER RISK ASSESSMENT TEMPLATE

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