Time is money

Counting the cost of client money management for law firms

shieldpay

Time is money, and the way law firms handle both is changing.

On both sides of the Atlantic, *it's been reported* that firms are moving away from the long-held tradition of client accounts. And it's easy to see why.

INCREASED REGULATION

Regulators such as the Financial Conduct Authority (FCA) in the UK have introduced much-needed regulation to crack down on client accounts being used as banking facilities. The Solicitors Regulation Authority (SRA) are aligned with these rules, and are particularly focused on scrutinising law firms holding large residual balances in their client accounts. When combined with the increased complexity of financial crime operations and the effect of global events on sanctions regimes, this means law firms must act in accordance with robust and evolving Anti Money Laundering Regulations (AML) and Know Your Customer (KYC) rules in order to remain compliant. No law professional wants to fall foul of regulators, incur disciplinary action, pay a substantial fine, or be charged with a crime that would put an end to their career, or even cause harm to their own reputation, or that of their firm.

DEAL DRAG

Industry regulation has also added to 'deal drag', with M&A deals proving long and painful to close. Professional services firm WTW's recent *Q1 2023 report* found that the median time to close deals in this quarter has been the slowest since 2008, with 71% of all deals taking at least 70 days to complete. Market uncertainty, complex stakeholder coordination and rigorous transaction reviews mean lawyers' jobs are only getting harder, while damaging the client experience.

RISING CYBER THREAT

75%

75% of UK law firms have experienced a cyber attack in the last 12 months[1], with ***phishing emails and impersonation scams*** amongst the most common types of attack.

75%

Over 75% of cybercrime reports were related to client accounts[1] indicating that law firms are at higher risk due to the handling of client monies.

75%

More than 75% of Top 100 firms have ***experienced a phishing attack.***[2]

As scams like this become more frequent and sophisticated, law firms' sensitive client data and their funds face heightened risk. And that's before taking into account the impact of cybercrime on firms' insurance premiums, lost time and resource spent on responding to attacks and the subsequent damage to client relationships.

1. A survey by the SRA, 2020
2. PwC's *2022 Law Firms' Survey*

If traditional tactics no longer cut it, then what can firms do?

Fortunately, there are alternatives available to using a client account. For some legal matters, transactional parties will send payments directly between one another. Where there is added complexity, escrow and paying agent services have been long-standing payment solutions legal teams have turned to, allowing them to reduce risk and time-consuming tasks that drain precious resources.

A key component to a deal's complexity is the international spread of transactional parties. When it comes to managing cross-border payments and juggling multiple currencies, using a third-party payment provider eases the process.

By using one all-encompassing payment solution, combining global access to payment rails and FX capabilities, international fund flows are seamless for legal teams and their clients.

Modern digital paying agent and escrow providers are now in the market offering solutions which take on the burden of due diligence, chasing and collating KYC information, so law professionals can concentrate on more profitable tasks. Thanks to automation tools, these checks can be processed efficiently, and the rise of open banking means bank details are also swiftly verified. This allows for smooth, transparent disbursement once payments are ready to send. In this way, firms can reduce the risk of fraud and fulfil their compliance obligations whilst minimising their workload.

Escrow services specifically, allow client funds to be held securely while a deal is finalised and certain conditions are met. For M&A deals, as an example, it is common to hold deferred considerations until a certain milestone is met, such as with an earn-out arrangement where the final payment is held depending on performance of the company over a set period of time. By using an escrow solution, all parties benefit from increased transparency and the certainty of a neutral, reliable third-party to safeguard the funds.

Against this backdrop of shifting needs and emerging solutions, we surveyed law professionals from the UK's Top 100 law firms.

Our research paints a picture of the current client money management landscape, explores law firms' challenges and examines the way transactions are set to evolve.

METHODOLOGY

In June 2023, Shieldpay carried out an online survey of 104 junior and senior law professionals from the Top 100 law firms in the UK.

Handling client funds and facilitating payments is a significant headache for law firms.

CONCERN ABOUT THE RISKS AND TIME COSTS ASSOCIATED WITH HOLDING CLIENT FUNDS.

73% of all legal professionals are concerned and 90% of junior law professionals are concerned.

It makes sense that junior law professionals are more concerned about risks and time costs - at the coal face of transactions, with fewer years of industry experience and the pressure associated with less senior positions, junior law professionals are more embroiled in client fund complexity. But it's an issue to take seriously as the industry seeks to tackle widespread *junior lawyer burnout.*

THE BIGGEST CHALLENGE FACED BY LAW PROFESSIONALS.

When it comes to handling client funds and facilitating payments on behalf of clients.

Managing international cross-border transactions

31%

Confidentiality and data security

28%

Insurance policies and limitations

28%

A LARGE INVESTMENT OF A FIRM'S TIME IS CURRENTLY DEDICATED TO DUE DILIGENCE.

On average, how long does it take your firm to complete KYC collection and verification on transactional parties when managing a payment?

24 hours or less	*16%*
2 - 3 working days	*40%*
4 - 9 working days	*32%*
2 - 3 weeks	*10%*
Don't know	*2%*

42% of law professionals say the most time-intensive aspect of handling client funds and managing payments is due diligence.

LARGER FIRMS

As could be expected, the larger the average deal size of a firm, the less likely law professionals say checks could be completed in 24 hours or less.

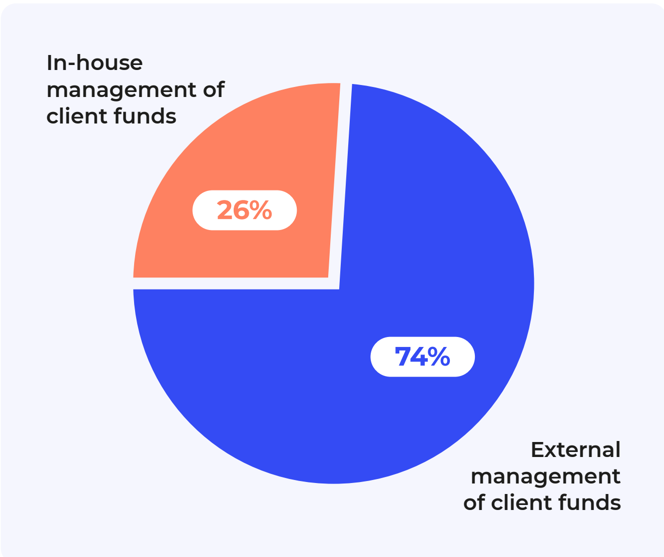
Law professionals at firms with an average deal size of £50-£100m were most likely to say checks take 2-3 weeks.

CHANGING ATTITUDES

Law firms are cognisant of the risk and regulatory minefield that is client money management, and new internal rules are being implemented.

When asked to describe how their firm's attitude is changing towards handling client money, three in five (60%) of the Top 100 law firms say they have put in place new rules to define their approach to handling client money.

New rules are being implemented within firms such as only being able to handle client money up to certain limits.



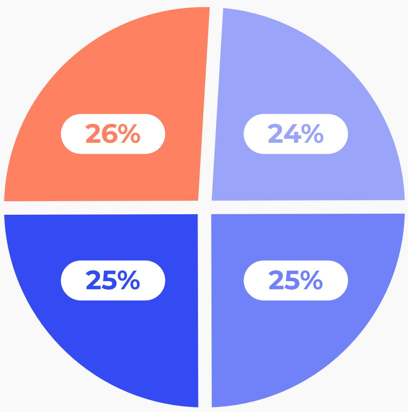
EXTERNAL MANAGEMENT

Due to these challenges, the majority (74%) of the Top 100 law firms are now opting for external management of client funds.

Among these, there's an almost even split of firms choosing to outsource to a paying agent or escrow provider, letting a client handle payment directly or engaging with a banking partner. However, 26% are still choosing to process payments internally using a client account.

In-house vs Third-party.

Currently, there's an almost even split amongst the methods used to manage transaction payments on behalf of clients.



IN HOUSE METHOD

Manage transaction payments internally, using a client account.

26%

THIRD PARTY METHODS

Outsource to a paying agent or escrow provider.

25%

The client handles the payment directly.

25%

Engage a banking partner.

24%

The popularity of third-party paying agents and escrow partners is likely due to the additional benefits they bring such as automated and streamlined KYC collection and verification, and enhanced client and stakeholder communication for greater transparency over a transaction.

SIZE OF DEAL AFFECTS CHOICE

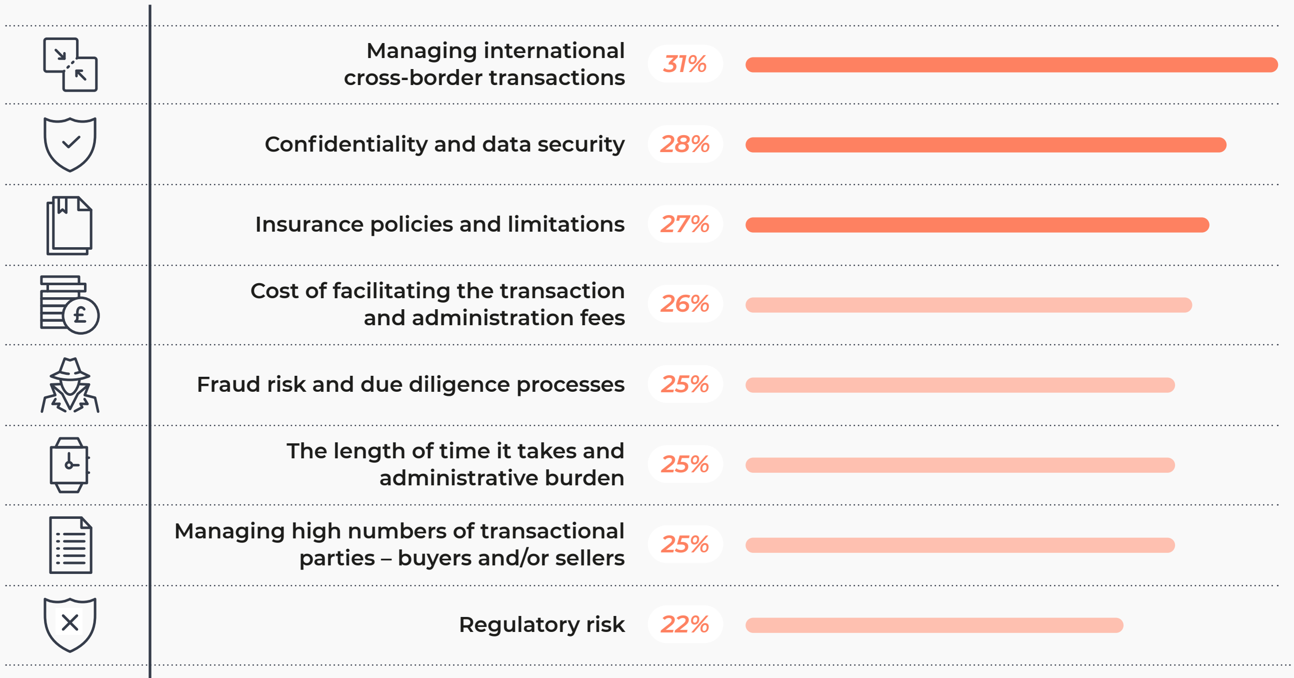
Law professionals from firms handling cases with an average deal value of less than £50m are more likely to manage transactions internally, while those from firms with an average deal value of £50m and above are more likely to outsource to a paying agent or escrow provider, or engage a banking partner. This indicates that while there's a broadly even split between Magic Circle firms favouring one of the four different payment options available to them (client account functions, digital escrow or paying agent, banking partner, direct client payments), the value of a deal is a key driver of this decision – with higher value, higher risk payments less likely to be managed in house.

MAGIC CIRCLE FIRMS

Magic Circle firms are most likely to engage a banking partner and least likely to outsource to a paying agent or escrow provider, indicating an opportunity for paying agent and escrow providers to emphasise the benefits of using a third-party payment provider and cultivate greater trust among this grouping of law firms. The type of firm most likely to outsource to a paying agent or escrow provider are national firms.

Challenges and use of time.

What, if anything, is most challenging when it comes to handling client funds and facilitating payments on behalf of clients?*



*Respondents could chose up to 3 answers

Top challenge for junior law professionals is the cost of facilitating the transaction and administration fees

32%

Top concern for senior law professionals is international cross-border transactions with multiple currencies

33%

DIFFERENT CHALLENGES FOR SENIOR AND JUNIOR LAW PROFESSIONALS.

Junior and senior law professionals find different areas most challenging. Junior law professionals are most challenged (32%) by the cost of facilitating the transaction and administration fees, whereas senior lawyers are most concerned about international cross-border transactions with multiple currencies (33%).

With fewer years under their belt navigating industry legislation, junior law professionals are also more than 1.5 times as likely as senior law professionals to cite regulatory risk as the most challenging area. More than 1 in 4 (28%) junior law professionals flag this aspect as most challenging, compared to 17% of senior law professionals.

*What is the most time-intensive aspect of handling client funds and managing payments on behalf of clients?**

Due diligence (KYC/KYB) checks	42%
Managing banking partners	35%
Regulatory reporting	34%
Managing external stakeholders and client communications	28%
Other administrative work	25%
Managing internal stakeholders	22%

*Respondents could chose up to 3 answers

Law professionals from firms with an average deal size of £50m and above are more likely to state due diligence is the most time-intensive aspect, than those at firms with an average deal size of below £50m, who are more likely to cite regulatory reporting.

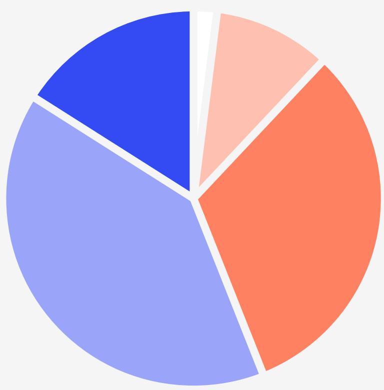
DUE DILIGENCE.

Due diligence was cited as the most time-intensive aspect of managing client funds and payments and our research puts numbers to this feeling. Two fifths (40%) of law professionals say it takes an average of 2-3 working days to complete KYC collection and verification on transactional parties when managing a payment, with checks typically taking 2-3 weeks for average deal sizes of £50-£100m.

Overall, almost 1 in 3 (32%) of the UK's Top 100 law firms say KYC collection and verification checks take 4-9 working days – representing a significant drain on firm resources and impacting deal completion timelines.

Average time to complete KYC collection and verification on transactional parties when managing a payment

16%	24 hours or less
40%	2 - 3 working days
32%	4 - 9 working days
10%	2 - 3 weeks
2%	Don't know



Client expectations.

Clients expect a seamless, secure and swift experience with law firms and these needs are keenly felt by law firms.

Nearly three quarters (73%) of law firms are concerned about the risk and time costs associated with holding client funds. This is felt most acutely by junior law professionals: 90% of whom say they are concerned, with almost a third (30%) stating they are 'very concerned'.

The data appears to bear this out with over a third (36%) of law professionals saying their firm has established rules and limitations to classify which transactions they can facilitate on behalf of a client via their client account. Yet almost 1 in 5 (18%) of Top 100 law firms do not have rules in place against handling client monies.

Over a quarter (28%) of law professionals say their firm is mindful of handling client money but the benefits still outweigh the risks for most transactions.

However, attitudes towards handling client money are changing. The majority (60%) of law firms say they have put in place new rules to define their approach to handling client money, such as only handling client money up to certain limits. Only 12% of law professionals say they're being encouraged to stop handling client money completely.

Out of the following, which statement is the most accurate description for your law firm?

My law firm has established rules and limitations to classify which transactions we can facilitate on behalf of a client with a client account.

36%

My law firm is mindful of handling client money but the benefits still outweigh the risks for most transactions.

28%

My law firm does not hold any client money.

18%

My law firm does not have any rules in place against handling client monies.

18%

Concern about risk and time costs associated with holding client funds.

76%	75%	67%	75%	72%
Magic Circle Firms	Silver Circle Firms	International Firms	National Firms	High Street Firms

What's next?

Our research shows a significant area of opportunity for law firms as well as paying agents and escrow providers.

With over a quarter of law firms still managing transaction payments in-house, despite the growing challenges of rigorous regulation, complex and time-consuming processes, as well as data security, ***there's a huge opportunity for law firms to reclaim junior and senior partner time - which can be redirected to higher value, billable tasks.***

Not only do third-party payment providers free lawyers from the administrative burden of manually processing transactions on behalf of clients, they also mitigate any financial risk associated with this activity – allowing legal professionals to focus on what they do best.

What's more, outsourcing client account functions allows firms to provide an enhanced customer experience, which in turn can help firms to grow their business. Not only are clients increasingly tech savvy, clients have become accustomed to seamless digital journeys, including a more secure approach to sharing personal information - and to wrestle with manual or inefficient processes in the legal sector is jarring. By using digital payment solutions, clients can benefit from swift due diligence checks - reducing deal times and the risk of a data breach - while experiencing seamless payouts. All this to say, with an enhanced payment journey, clients can have confidence in the safety of their funds and greater trust in their law firm.

Using digital payment providers not only increases client satisfaction, it improves the operational efficiency of law firms too. There's no need for multiple-currency transactions to be a source of dread. When laborious, traditionally manual tasks are outsourced and automated, law professionals can concentrate their valuable time on higher level - and, crucially, billable - duties. This means professionals can work more quickly and aren't snowed under with avoidable tasks, unlocking firm time that can be used to chase new business, not customer information.

Additionally, outsourcing payment functions can help law firms grow by enabling them to expand their service expertise area, for example, making it easier for them to expand to class litigation claims.

But there's internal work to be done beyond embracing new technology. ***Almost 1 in 5 law firms say they do not have rules in place against handling client monies, which is playing with fire in this current environment***. All firms should examine the rules they currently have in place, assess their risk and consider whether they are adequately supporting their team in meeting payment requirements. If 9 in 10 junior law professionals are concerned about the risk and time costs associated with holding client funds, what internal education and support can firms offer to improve this? And how this might be impacting talent attraction and retention?

Client money management shouldn't come at a heavy cost to law firms. New digital solutions are emerging that enable them to meet growing industry challenges and rising customer expectations, whilst improving the quality and efficiency of their work.

With the outsourcing of client accounts key to unlocking both resources and revenue for law firms, it's high time the industry raised the bar on payment automation.