

FUTURE MARKET CHANGES IN THE LEGAL SECTOR AND THEIR POTENTIAL IMPACT ON CLIENT MONEY

Research to inform the SRA's Consumer
Protection Review

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1 Executive summary

The Solicitors Regulation Authority (SRA) commissioned Frontier Economics to study future market changes in the legal sector and their potential impact on client money, in the context of their [Consumer Protection Review](#).

This research has been conducted in two stages. First, we carried out a focused evidence review of over 90 publications, to gather insights on key changes affecting the legal sector which may impact consumers and client money. Second, we held in-depth conversations with a small number of sector experts, to explore the issues identified from our evidence review in greater detail.

Our research identifies a range of potential risks to consumers, with a focus on the safety of client money in the legal sector. Our report highlights the following risk factors relating to client money in the short to medium term.

- **Risk of misappropriation.** Evidence suggests that this risk is heightened when firms face financial difficulty, when employees work under high pressure or when there is insufficient supervision taking place.
- **AI and cyber risks.** These risks are identified as significant and therefore should be considered high priority for legal service providers, as these may have significant and costly consequences for clients of firms of all types and sizes. Our research suggests that there is scope for improvement in preparedness and cyber risk management across the board.
- **Long-term viability of legal firms.** Any risk of firm closure, whether driven by financial distress or structural issues, may put client money at risk, at least in the short term before any claims for insurance or compensation materialise.

The findings highlighted in this research would be strengthened by internal SRA evidence gathering and empirical analysis of secondary data. Analysis of changes to factors including firm funding models, structures and solicitor demographics over time, coupled with data on claims from the SRA's Compensation Fund, can help understand risk factors in a more quantitative sense. This could then be used to confirm or indeed challenge any trends identified by publications and external commentators.

The SRA could also continue to monitor the developments identified in this report, to ensure that sustainable and transparent business practices are maintained and that legal firms take appropriate action to mitigate the concerns identified.

2 Background

As the legal landscape evolves, there are a number of market changes which may affect consumers and have a potential impact on client money when it comes to the provision of legal services.

As part of the SRA's [Consumer Protection Review](#), Frontier Economics was commissioned to undertake an analysis of the key market changes in the legal sector over the medium term, in order to assess the largest potential impacts for consumer protection, and identify which in particular pose a risk to client money.

Our key research objectives were as follows.

- To highlight the key market changes which seem likely to take place, covering both risks and opportunities.
- To outline the potential impact of those changes with respect to consumer protection and specifically protecting the consumers' money held by law firms, referred to as 'client money'.
- To provide detail of any high-level mitigations which may be relevant for consideration in the SRA's Consumer Protection Review.

3 Methodology

We conducted the research in two stages:

- First, a focused evidence review, to gather insights on key changes affecting the legal sector which may impact consumers and client money.
- Second, in-depth conversations with four sector experts, to explore the issues identified in greater detail.

Evidence review

We conducted desk-based research to identify the key changes affecting the legal sector and the latest commentary on the extent to which these changes are expected to impact consumers, in particular client money.

This research covered publications from private organisations, umbrella bodies, government departments, arm's length agencies and other relevant organisations. In total, Frontier reviewed more than 90 relevant publications.

Studies were categorised into thematic risk groupings, and findings were synthesised, highlighting key insights and any gaps in understanding.

Consultation with sector experts

We arranged conversations with sector experts with the aim of validating the findings emerging from the evidence review, and discussing their views on key changes in the legal sector which may pose risks to consumers.

While the subject of risk in legal services is extensively studied with multiple organisations producing publications (including the SRA itself, which publishes its Risk Outlook as well as other reports focusing on specific areas of risk), the implications of these changes for consumers is not always explicitly indicated. Consultation with sector experts enables us to contextualise these findings and provides us with the nuances behind some of these market observations in order that we can draw the necessary inferences.

Four experts across key areas of legal service provision and insurance were identified through SRA and Frontier networks. Engagement took place in September 2024, with each interview facilitated by a member of the Frontier Economics team and lasting between 30 – 60 minutes.

As the experts were asked to report on their individual experiences, it should be noted that the insights gathered from this aspect of the research are not exhaustive of all potential risks which may materialise.

We are extremely grateful to these experts for their participation in this work.

4 Research findings

Our research has identified a number of factors which may give rise to risks for consumers of legal services now or in the future. These risks may originate from external factors or from the activities of firms and consumers within the legal market.

Our approach highlights key risk areas identified from the evidence review which have shown evidence that we consider may have an impact on the protection of client money, even if this has not been explicitly stated.

In the following sections, we explain each risk factor in greater detail, and explore the extent to which there is evidence to demonstrate implications for consumers of legal services and their money.

4.1 Risks arising from external factors

4.1.1 Prevailing high costs

Context

Law firms have been experiencing higher operating costs than usual due to sustained general inflation, higher than usual staff costs and elevated insurance costs.

Although inflation rates have reduced to pre-COVID-19 levels, the cost of living crisis continues as price levels remain high and continue to rise, albeit at a slower pace¹.

Staff costs have increased in part to improve recruitment and retention levels². Competition for talent from international firms, particularly US firms, has also forced large corporates to more closely match salaries to these competitor firms³.

Sustained high costs from compulsory professional indemnity insurance (PII) have posed significant financial burden for law firms, for which PII is one of the top three annual expenses⁴. According to the SRA Indemnity Insurance Rules, regulated law firms are required to obtain PII cover. Those who fail to obtain cover are required to cease practice⁵. The Law Society found that the median cost of PII cover rose by 23% for small firms and by 15% for sole practitioners in the financial year 2022 (FY22)⁶. Although premium rates have generally

¹ [Rising cost of living in the UK](#), July 2024, UK Parliament

² [Annual Law Firms' Survey 2023: Bold steps to sustainable transformation](#), October 2023, PricewaterhouseCoopers

³ [UK Law Firms' Salary War Risks Their Ability to Expand, Compete](#), May 2024, Bloomberg Law

⁴ [Legal update: Law firm closures due to failure to get Indemnity Insurance falls to lowest level since 2018/19](#), March 2024, Hazlewoods

⁵ [SRA Indemnity Insurance Rules](#), last accessed September 2024

⁶ [Do you know your practice?](#), September 2023, The Law Gazette

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stabilised or declined in the April 2024 renewals, they vary depending on firms' financial health and risk profiles⁷.

Implications

There is a risk that the high costs experienced by firms may be passed to consumers. A study by Litera showed that more than half of UK firms said they were changing their pricing model and increasing fees to cope with economic changes⁸. Recent evidence from the UK and US found that 91% of legal services increased pricing last year and 86% will increase it again, with a fifth of respondents expecting to raise prices between 41-60%⁹.

On the other hand, higher than usual inflation experienced by legal consumers may maintain the pressure on law firms to remain competitive. A survey of 200 law firm partners across the UK noted that 46% of partners said clients were moving work to less expensive competitors, and 44% of partners reported they were under pressure to reduce their fees in the face of increasing costs. Furthermore, 41% of partners indicated that competition was an important factor in setting their firm's strategy, a 20% increase on what was reported in 2021. Harbour found that client needs and demands were the leading factors influencing law firm strategy¹⁰.

In response, firms are also working towards cost-cutting solutions. In its 2023 survey, Harbour found that 35% of partners said they were looking at reducing numbers of support staff, and a similar percentage (34%) were looking at reducing numbers of fee-earners¹¹.

This may have the implication of slower growth across legal services in the short to medium term. The ongoing economic uncertainty has been cited as the most significant barrier to growth for law firms over the next 12 months. In a survey of 100 law firm leaders by Hayhurst Consultancy, just 5% of law firm leaders said they did not anticipate their firm facing any growth challenges in the coming year¹². Harbour noted that *"it appears law firms can see opportunities for growth but feel held back by economic uncertainty and increasingly limited access to capital for investment."*¹³

If high costs are sustained, this may threaten firm viability and result in business shutdowns. In 2023, UK law firms experienced a 33% increase in insolvencies driven by high operating costs, combined with reduced demand and delays in client payments following the recent cost of living crisis¹⁴. Any material increase in the number of firm closures would require

⁷ [Large Law Firms: PII Market Update April 2024](#), April 2024, Lockton

⁸ [Navigating the Legal Horizon: Trends in AI Integration, Alternative Fee Arrangements, and Profitability Metrics](#), April 2024, Litera

⁹ [Trends Analysis for Legal Pricing and Budgeting](#), 2024, BigHand

¹⁰ [Clients vote with their feet as rising costs bite](#), October 2022, Harbour Litigation Funding

¹¹ [Half of law firm partners looking to set up own firm](#), February 2023, Harbour Litigation Funding

¹² [The Harbour White Paper](#), February 2024, Harbour Litigation Funding

¹³ [Partner caution and client demands "limiting law firm growth"](#), February 2024, Legal Futures

¹⁴ [Law firm finances under fire – what happens when solicitors suffer financial difficulty?](#), October 2023, Howard Kennedy

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management by the SRA, which may have resource implications in the short term. In addition, this has direct access to justice implications for consumers, to the extent that firm shutdowns are focussed in specific regions or categories of legal practice; further research is required to assess the scale of this risk.

Going forward, predictions suggest that high costs are likely to continue. Although wages in 2023 rose faster than inflation rates, and energy prices fell, other economic issues like worker shortages are likely to keep prices high in the near future¹⁵. However, law firms remain financially resilient¹⁶ and are optimistic about the scope for recovery. Harbour's white paper records confidence across law firms in the upcoming year's trading, with 56% expecting increased turnover and 60% higher profits in 2024¹⁷. As such, it will be important to monitor developments over the next months as forecasts develop.

Insights from sector experts

The legal experts we spoke with agreed that operating costs had increased significantly in recent years, with inflated operating costs and increasing salaries identified as the two major drivers.

One expert commented that these increased costs have been less challenging for large corporates that are typically able to benefit from diversified portfolios of work across legal practice types and geographic regions. On the other hand, the experience has been more challenging for smaller and more specialised law firms, that are unable to hedge their exposure in this way.

4.1.2 Insurance provision

Context

The SRA requires legal service providers to obtain PII for consumer protection. Insurers in recent years have experienced excessive claims inflation due to more litigation, claimant-friendly judgments and higher damage awards. COVID-19 and its rippling effects have caused a surge in litigation brought against law firms and their PII policies, including claims from clients against errors or negligence in services, and claims from employees against wrongful dismissals^{18,19}.

Recent court decisions have also led to high value claims. For instance, in April 2023 *Discovery Land Company LLC v. AXIS Specialty Europe SE*, one of the two partners of a law

¹⁵ [Cost of living crisis: what is it and when will it end?](#), February 2024, BBC

¹⁶ [Law firms remain resilient in tough economic times](#), March 2024, The Law Society

¹⁷ [Partner caution and client demands "limiting law firm growth"](#), February 2024, Legal Futures

¹⁸ [Running for cover](#), September 2020, The Law Gazette

¹⁹ [Have we reached the peak of soaring PII costs?](#), 2021, BDO

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firm committed substantial theft from client accounts. The court ruled that the other partner was innocent and did not condone the theft, leaving insurers to bear the losses²⁰.

Finally, a number of high-profile law firm failures in recent years²¹ have left insurers with six years' worth of run-off claims and no premium income. Consequently, insurers have come to pay closer attention to firms' financial wellbeing and claims history. Those with a history of frequent or high-value claims may face higher premiums, or even be refused cover from insurers²².

Implications

These factors have contributed to higher PII costs and insurer caution with PII provision. In turn, higher PII premiums have increased the challenge for firms to obtain affordable and comprehensive PII, without which they are unable to operate. Hazlewoods reported that 36 firms closed in 2021/22 due to inability to obtain PII cover, and a further 34 closed in 2022/23 for the same reason²³. Silks Solicitors Limited, for instance, went bankrupt partly due to a 238% increase in PII cover from £88,000 in 2020 to £210,000 in 2022²⁴. A 2023 Law Society survey of 600 law firms and sole practitioners found that the percentage of respondents who found obtaining PII cover "very easy" or "fairly easy" decreased from 76% to 56% between 2018 and 2023²⁵.

Conveyancing firms and firms with a track record of frequent or high value claims may find this particularly challenging due to their high-risk profiles. Small firms may also find obtaining PII especially difficult due to large PII cost to turnover ratio²⁶. The Law Society study referenced above noted that small firms were particularly vulnerable due to higher PII cost to turnover ratio²⁷.

As elevated PII premiums contribute to higher operating costs for firms, the expected impact on consumers is similar. That is, the risk of increased prices for legal services, and cost-cutting measures which may come at the expense of service provision if not handled appropriately. Any risk of firm closures will similarly have access to justice implications for consumers (see section 4.1.1 above).

Although the recent April renewal has seen stable and declining PII rates in general, Lockton warns that market conditions are profession-specific, where differentiated risk profiles and

²⁰ [Professional liability report 2023: Trends and future risks](#), July 2023, Kennedys Law

²¹ [Special report: Trade creditors pay £800 million price of law firm failures](#), August 2024, The Law Gazette

²² [Solicitors PII: What happens if you can't get cover... at a price you can afford to pay?](#), February 2024, Legal Futures

²³ [Legal update: Law firm closures due to failure to get Indemnity Insurance falls to lowest level since 2018/19](#), March 2024, Hazlewoods

²⁴ [Firm floored by 238% hike in indemnity insurance bill](#), April 2024, The Law Gazette

²⁵ [News focus: trends in professional indemnity insurance 2023 - main findings](#), July 2023, The Law Gazette

²⁶ [Solicitors PII: What happens if you can't get cover... at a price you can afford to pay?](#), February 2024, Legal Futures

²⁷ [News focus: trends in professional indemnity insurance 2023 - main findings](#), July 2023, The Law Gazette

therefore premium rates depend on the area of specialisation (e.g. firms specialised in conveyancing still face high PII costs)²⁸.

Insights from sector experts

The legal experts we spoke with reflected that PII premiums had risen materially over the last three years, for all firms regardless of their track records and risk profiles. Nevertheless, they observed reasonable stability in premiums for the most recent year.

The insurance representative agreed that claims inflation has been of some concern, particularly through the cost of living crisis, alongside a number of high profile insolvencies.

They suggested that the increase in caution is partly due to the difficulty for an insurance company to reject a claim. As a result, it has largely been premiums that have increased to match the payments that have been required, although the scope of claims coverage remains broadly the same. They noted that some PII providers have tightened their criteria, for instance by reducing their appetite for conveyancing and personal injury firms (given that these categories of work form the largest sources of claims).

The insurance representative noted that while they had observed an increase in firms struggling to pay for PII cover, they believed that firms rarely ceased to practice as a direct result of inability to obtain PII or to pay PII premiums.

4.1.3 A changing regulatory environment

Context

A fast-evolving geopolitical landscape keeps regulatory compliance a key concern for law firms. New regulatory frameworks may be on the horizon, which would add compliance requirements for firms and solicitors.

A recent example is the new Legal Services Operational Privacy Certification Scheme approved by the Information Commissioner's Office to help law firms comply with General Data Protection Regulation (GDPR) requirements in order to increase client trust. Although the certification is not yet mandatory, it could become standard for law firms handling client data²⁹.

Furthermore, compliance with Anti-Money Laundering (AML) requirements continues to be challenging for law firms. According to the 2020 UK National Risk Assessment, the legal sector continues to be assessed as "*high risk*" for money laundering exposure³⁰. However, many law

²⁸ [Large Law Firms: PII Market Update April 2024](#), April 2024, Lockton

²⁹ [New ICO certification for lawyers gives "certainty" on data processing](#), February 2024, Legal Futures

³⁰ [How 'risky' is the Legal Sector and what are the new AML requirements for Firms in 2021](#), March 2021, BDO

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firms struggle to have proper AML procedures in place. The SRA 2022-23 AML annual report³¹ noted that 51% of inspected firms were partially compliant or non-compliant with AML regulations, and 26% of inspected firms failed to address international sanctions. The most common compliance failures include inadequate staff training and outdated AML policies that refer to old legislations. With ongoing updates to AML risk assessments and international sanctions, AML compliance will likely remain a key concern for law firms.

In the context of an increased SRA budget for AML supervision and risk-based firm inspections, BDO notes that firms should expect stronger regulatory enforcement going forward in this respect³². Non-compliant firms would face disciplinary actions including fines and suspension. For example, the top-50 firm Clyde & Co was fined £500,000 in 2024 for non-compliance by the Solicitors Disciplinary Tribunal³³. Law firms classified as alternative business structures (ABS) may face even larger fines, since the SRA has a higher fining threshold for ABS³⁴.

Finally, more regulations with respect to the use of AI in the legal profession are expected. The Legal Service Board's (LSB) 2024 AI strategic plan has described the intended regulatory approach to be *"outcomes-based, technology-neutral, non-prescriptive...through statutory guidance"*³⁵. However, given the rapid development of generative AI and shifting digital regulation landscape, the Law Society cautions that law firms should understand the risks and protections in place under existing regulations.

Implications

Changing regulation requires firms to remain diligent, and additional compliance requirements can add costs to businesses as new regulations may require significant investment in technology, training, and specialised personnel. Non-compliance of any kind could lead to financial losses, legal consequences and reputational damage. These costs may be more burdensome for smaller organisations, due to a lack of economies of scale³⁶. As a result, consumers may be the subject of unintended consequences, such as disrupted business operations or in the worst cases, firm dissolution, which can mean that any money held by the legal firm becomes inaccessible (at least in the short term, until claimed from insurance or the SRA's Compensation Fund).

In addition, a perceived trade-off between regulatory compliance and firm advancement may pose a risk to the service quality offered to consumers. Increased regulatory compliance was the most commonly identified barrier to technological change among the 1,310 legal service

³¹ [Anti-Money Laundering annual report 2022-23](#), October 2023, Solicitor's Regulation Authority

³² [How 'risky' is the Legal Sector and what are the new AML requirements for Firms in 2021](#), March 2021, BDO

³³ [Clyde & Co fined £500,000 after admitting due diligence failure](#), January 2024, The Law Gazette

³⁴ [The SRA's approach to financial penalties](#), May 2023, Solicitors Regulation Authority

³⁵ [Generative AI: the essentials](#), 2024, The Law Society

³⁶ [Cutting the costs of AML compliance](#), 2021, LexisNexis

providers surveyed by the LSB³⁷, with 8% of respondents identifying it as a significant constraint and a further 27% a small constraint.

Insights from sector experts

Legal experts we interviewed echoed the need for due diligence to remain compliant with regular changes in SRA guidance. Each firm must appoint a Compliance Officer for Legal Practice (and a Compliance officer for Finance and Administration) who is obligated to ensure the firm remains updated on the latest regulatory developments, that staff are trained and that systems are adjusted according to these developments. Firms may of course put in place proactive processes to support these minimum requirements.

4.2 Risks arising within the legal sector

4.2.1 High levels of firm debt

Context

Firms are accruing more debt as clients take longer to pay bills in the context of the economic downturn.

Average lock-up time, or the time the UK's Top 100 law firms wait to receive payment after work completion, was longer than four months in 2023; by contrast, businesses in other sectors experience an average waiting period of 56 days³⁸. The problem is found to be worse for smaller law firms, with firms listed in the bottom half of the top 100 waiting on average 133 days to receive payment.

As a result, law firms have been faced with increasing debt levels. Based on an analysis of annual reports of top law firms filed in the year to 30 November 2023, Lubbock Fine found that total debt among the UK's top 50 law firms increased by £177m to £5.4bn between 2022 and 2023³⁹. A survey of 100 law firm leaders by Hayhurst Consultancy, found that one third said their firms were actively considering using credit facilities from litigation funders, from which they already sourced funding for clients' claims⁴⁰.

Implications

Weak cashflow heightens the risk of financial distress and insolvency. According to Lubbock Fine, the risk of long lock-up time is always exacerbated by economic downturn and could

³⁷ [LSB survey reveals pandemic-driven tech innovation in law firms and consumer benefits](#), June 2023, Legal Services Board

³⁸ [Law firms wait more than four months to get paid](#), September 2023, Lubbock Fine

³⁹ [Law firms wait more than four months to get paid](#), September 2023, Lubbock Fine

⁴⁰ [Partner caution and client demands "limiting law firm growth"](#), February 2024, Legal Futures

result in knock-on effects for the business. For instance, banks are less willing to extend overdrafts to firms with debts older than 90 days⁴¹.

Law firms with the longest payment delays are those specialised in litigation, probate and property. This is because these specialisations do not tend to receive payment until the completion of work, which may take months or years⁴².

The increased risk of a law firm's financial distress may in turn increase the risk to its clients' funds. The 2013 SRA Compensation Arrangements Review⁴³ found that from 2007 to 2012, an average of 1.1% regulated firms were found to have misused client money. The most common driver of these cases was financial distress of the firm or individuals within the firm. The review noted that economic downturns increase the risk of misuse of client money due to financial distress. Additional evidence from LexisNexis and KPMG has also shown that firms experiencing financial difficulty are at a higher risk of misappropriating or misusing client money^{44,45}.

Insights from sector experts

An insurance representative that we spoke with supported these findings, also noting high debt levels as a recent trend.

A legal expert we interviewed suggested that returning to the mandatory submission of annual accountant reports would help the detection of risk to consumer money. Currently, SRA rules only require the submission of annual reports if money belonging to clients or third parties is, has been, or is likely to be placed, at risk.⁴⁶ The expert noted that this would be facilitated by the introduction of some software to enable the online submission of these reports.

4.2.2 Market changes

Context

Law firm growth can be achieved through a number of means, but in particular there has been a rise in merger activity in the legal sector. Among smaller firms, the key motivation seems to be cost savings opportunity in the context of a tough economic environment. By contrast, among larger UK firms, merger activity seems to be driven by increasing competition on the global market. For instance, Allen & Overy, one of the Magic Circle firms, merged with Wall Street firm Shearman & Sterling earlier this year to preserve its leading position in the legal

⁴¹ [Law firms' debt & lock-up time: on the rise](#), April 2024, New Law Journal

⁴² [Law firms wait more than four months to get paid](#), September 2023, Lubbock Fine

⁴³ [SRA Compensation Arrangements Review](#), June 2013, The Solicitor's Regulation Authority

⁴⁴ [Client money](#), November 2020, Solicitors Regulation Authority

⁴⁵ [Forensic focus: Fraud risk increases in difficult economies](#), July 2017, KPMG

⁴⁶ [Client accounts and accountants' reports](#), March 2023, The Solicitor's Regulation Authority

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market⁴⁷. The Law Gazette reported that “As the average size of firms increased over the last decade, the overall number of law firms dropped by 13% over the same period, from 10,867 in 2013 to 9,498 in 2023. This reduction has been partly driven by mergers, which increased by 23%, from a reported total of 99 in 2021 to 122 in 2022”.⁴⁸

This trend is expected to continue, with 42% of law firm leaders surveyed by Hayhurst Consultancy predicting that 2024 is going to be one of the busiest years for law firm merger and acquisition activity⁴⁹. Market attitude towards external ownership remains positive. In a 2023 survey of 200 law firm partners commissioned by Harbour, 75% of respondents noted that they would consider external ownership⁵⁰. 78% of partners would consider a lending facility from a third party, and 75% of partners would consider external ownership⁵¹.

Implications

The growth and consolidation of legal firms is to be expected in a well-functioning market. These changes need to be well managed and sustainable; rapid and unstructured growth (of any form) may give rise to cash flow crunches, operational inefficiency and in the worst cases, insolvency or SRA intervention, where the SRA steps in to close a firm. These issues may all result in risks for clients and their funds.

Problems might arise when firms grow too fast to adequately scale their supervisory functions or reporting.)

The SRA has highlighted the risks from ‘challenges in respect of business integration, organisational culture, and maintaining standards of service to increased client numbers. Managers of a firm should always make sure that acquisitional growth does not lead to ineffective governance structures, systems or controls which could cause detriment to clients or undermine trust in the profession’⁵².

Market commentators observe continued high levels of merger activity which shows no sign of slowdown, with 121 deals agreed in 2024⁵³. Despite the relatively high levels of recent merger activity in the UK legal sector, chartered accountancy firm Saffery finds that 92.9% of UK law firms have less than 20 total employees, suggesting scope for continued consolidation in the market⁵⁴.

⁴⁷ [A&O Shearman Merger Shock Waves Ripple Through UK’s Magic Circle](#), May 2024, Bloomberg

⁴⁸ [Why law firm mergers are on the rise](#), January 2024, The Law Gazette

⁴⁹ [Partner caution and client demands “limiting law firm growth”](#), February 2024, Legal Futures

⁵⁰ [Three quarters of law firms would consider external ownership](#), May 2023, Harbour Litigation Funding

⁵¹ [Half of law firm partners looking to set up own firm](#), February 2023, Harbour Litigation Funding

⁵² [SRA | Mergers, acquisitions and sales of law firms - Warning notice | Solicitors Regulation Authority](#)

⁵³ [Little slowdown in UK law firm mergers – 121 in past year](#), October 2024, Hazlewoods

⁵⁴ [UK legal sector: Review of mergers and acquisitions activity](#), June 2023, Saffery

Insights from sector experts

The experts we spoke with described a sense of ‘grow or die’ mentality among some law firms in the market. They identified mergers of medium to large firms as a current trend, particularly driven by firms branching into other areas of work, e.g. management consultancy, tax services or IT, to provide a one-stop shop for their clients.

The experts echoed the above findings; mergers can work well if done correctly and the proper due diligence has been performed. One gave the example of the merger between business law firm DWF and professional indemnity practice Fishburns, noting that the merger allowed the expansion of DWF into the new field of insurance and helped to enhance its reputation⁵⁵. However, risk arises if growth takes place too quickly and it becomes evident that firms no longer have effective governance structures, systems or controls.

4.2.3 Diversification of funding arrangements

Context

The liberalisation of the legal market following the 2007 Legal Services Act has resulted in a much more diverse legal landscape in recent years.

In addition to traditional law firms, large professional services firms have entered the market. According to a Thomson Reuters study in 2023, 10% of UK law firms surveyed had competed with the Big Four accounting firms in 2022, and 13% of these had lost work to a Big Four firm⁵⁶. The study predicts a likely intensification of competition, with both EY and PwC planning to increase their legal headcount in the UK (threefold and twofold respectively), and the Big Four branching into more areas of legal services.

Alongside the growth of ABS firms, freelance solicitors and virtual firms, a 2023 survey of 200 law firm partners, commissioned by Harbour found that the vast majority of firms are willing to consider using alternative funding in the next 12 to 18 months. Types of funding considered include bank loans (82%), damage-based agreements (79%), credit or lending facilities from litigation funders (78%), and stock market listing / non-lawyer shareholders (77%)⁵⁷.

Finally, the UK legal tech start-up and scale-up ecosystem has seen significant growth in recent years, with the number of lawtech businesses increasing from 37 to 356 between 2002 and 2023⁵⁸. Demand for lawtech is estimated to be worth £22bn to the UK economy, and with employment estimated to double by 2026, further growth is likely⁵⁹.

⁵⁵ [DWF & Fishburns](#), February 2013, New Law Journal

⁵⁶ [Alternative Legal Services Providers 2023](#), February 2023, Thomson Reuters Institute

⁵⁷ [Three quarters of law firms would consider external ownership](#), May 2023, Harbour Litigation Funding

⁵⁸ [LTUK ecosystem tracker](#), April 2024, Lawtech UK

⁵⁹ [Assessing the economic value of LawTech](#), August 2022, Regvisory

Implications

Several risks may arise from the uncertainty surrounding the nature of these new funding models, although the evidence available to date is limited.

Virtual firms, given their completely digital nature, potentially face higher cyber risks (e.g. hacking, information leaks, data breaches, and technical failures), as well as greater supervision challenges⁶⁰. They may thus be considered higher risk for the handling of client money given their higher susceptibility to cyber-attacks and internal fraud, which in both cases would result in a loss of funds and undermine consumer trust in the legal provider and profession more widely. A lack of physical interaction may also render miscommunication with consumers more likely, with implications for quality of service⁶¹.

SRA disciplinary records, however, show that ABS firms fare no better or worse than traditional law firms⁶². While the SRA imposes a higher fining threshold for ABS, the largest fines have still involved traditional law firms⁶³.

Among ABS there has been a rise of private equity investment in law firms⁶⁴, which has been identified as a potential risk to client service, as investors' interest may be prioritised over clients' interest. As investors prioritise profit maximisation, this may force legal firms to cut costs, increase charge-out rates, and prioritise high-margin work, all of which may negatively impact affordability for clients and their access to legal services⁶⁵.

Insights from sector experts

The experts we interviewed emphasised that ABS firms in and of themselves are not risky, and that as long as these organisations are well run, they should not pose any higher risk to consumers than traditional law firms. One expert discussed the potential benefit of bringing in experts from other professions who may contribute to the better running of law firms as businesses.

Commenting on foreign ownership, an insurance expert we spoke with suggested that the level of risk depends on the interest of the foreign entity. For instance, if the motivation of the foreign ownership is to establish a footprint in the local market, this may be justified.

On the other hand, those who acquire for investment may pose greater risk to a law firm's viability, particularly if they retain the ability to withdraw investment at short notice and are especially focussed on short term gains at the expense of sustainable growth. This may leave

⁶⁰ [How to Overcome the Challenges of Managing a Virtual Law Firm](#), March 2020, G2B Social

⁶¹ [How to Overcome the Challenges of Managing a Virtual Law Firm](#), March 2020, G2B Social

⁶² [Flexing the abs](#), March 2022, The Law Gazette

⁶³ [SRA issues more fixed penalties](#), January 2024, Solicitors Regulation Authority

⁶⁴ [Private equity in the legal sector: A challenge to conventional firms](#), January 2024, Legal Futures

⁶⁵ [How Private Equity Investment is Disrupting the Legal Industry](#), December 2023, Best Lawyers

a firm with no time to build its own financial resources, and in some cases can compromise firm activity and result in closure. A similar argument can be made for private equity investment and ownership. In this event, there may be direct consequences for any client money held by the firm, and may leave some clients struggling to find alternative representation while their case is ongoing.

Regarding freelance solicitors, an insurance expert we interviewed noted that these remain a small segment of the legal market, and so there is scope for greater understanding about their methods of operation. A legal expert we spoke with noted that a potential risk may be in the organisation of administrative functions, as freelance solicitors may not have the same degree of support as if they were operating in a traditional business entity. The legal expert noted that of primary importance is to ensure that freelance solicitors are still held to the high standards of regulation as all other legal practitioners⁶⁶.

4.2.4 Cybercrime

Context

The fundamental challenge of how cybercrime threatens the data and information held by firms has not changed in the last few years. According to PwC, hackers continue to target human vulnerabilities and exploit poor security behaviours. Among Top 100 law firms surveyed by PwC, 77% have experienced incidents unintentionally caused by staff and 8% of firms have experienced an incident caused by a malicious insider⁶⁷.

However, firms face increased exposure to cybercrime as they become increasingly dependent on IT and the sophistication of hackers increases. The most significant threats include phishing and email modification fraud, ransomware, and attacks on third parties and providers, which may spread to solicitors' firms. The National Cyber Security Centre noted in 2023 that the legal sector remains attractive to cyber criminals due to the large amounts of money and sensitive data handled (which would include consumer money held in the firm client account and consumer data)⁶⁸. It added that remote working, where employees connect to corporate network from home routers, has increased firms' exposure to cyber risks.

Lawyers undertaking conveyancing transactions remain particularly susceptible to cyber-attacks such as phishing and business email compromises, since these solicitors frequently handle large sums of funds with a wide number of parties⁶⁹.

Law firms' increasing reliance on third party technologies and AI has also increased the risk to client data and money, as they become gateways for hackers to infiltrate a large number of

⁶⁶ Note that the [Code of Conduct for Solicitors](#) does apply to all practitioners regulated by the SRA.

⁶⁷ [Annual Law Firms' Survey 2023](#), PwC, October 2023

⁶⁸ [Cyber Threat Report: UK Legal Sector](#), June 2023, National Cyber Security Centre

⁶⁹ [Professional liability report 2023](#), July 2023, Kennedys Law

law firms at once⁷⁰. For instance, MOVEit, a file transfer app, suffered from a cyber-attack in 2023, which led to data breaches for numerous users, including legal service providers⁷¹. Another such example is the attack on CTS in November 2023, a commonly used IT service provider by law firms, which led to the compromise of close to 80 conveyancing firms. In the worst cases, firms were unable to access their case management systems to allow them to complete transactions⁷². The risk with concentrated third party providers is not unique to IT services, as law firms also frequently outsource functions like legal research, document review services, and marketing services⁷³.

Implications

Victims of cyber-attacks may face operational disruption, the compromise of confidential or sensitive information, the spread of misinformation, financial losses and/or reputational damage⁷⁴. This can increase the risk of money laundering, terrorist financing, and sanctions risk in transactions.

The financial damage from cyber-attacks is of particular concern. Since first-party losses as a result of cyber risk is not covered within the scope of traditional PII (i.e. losses directly affecting the law firm)⁷⁵, law firms without additional cover are exposed to significant and unexpected risk. In July 2023, the Law Society found that 72% of firms have not purchased separate cyber cover⁷⁶. Paragon, a specialist insurance broker, noted that causes of the low uptake include law firms' misconceptions that cyber risks are covered by PII, and complacency in believing cyber-attacks would not happen to them⁷⁷.

Because of this insurance vacuum, cyber-attacks may be more likely to cause unrecoverable financial loss and firm closure, thereby posing very high risks to client money. In the 2020 SRA Cyber Security thematic review⁷⁸, 75% (30) of firms reported having been targets of a cyber-attack. While not all incidents culminated in a financial loss for clients, 23 of the 30 cases in which firms were directly targeted saw a total of more than £4 million of client money stolen. The SRA also pointed to the wider cost implications of cyber-attacks, such as higher insurance premiums and lost time (one firm reported that it lost around £150,000 worth of billable hours following a system collapse resulting from a cyber-attack).

⁷⁰ [CTS cyber incident, The Law Society, December 2023](#)

⁷¹ [Professional liability report 2023: Trends and future risks](#), July 2023, Kennedys Law

⁷² [News focus: Cyber-attack hits conveyancing firms – what lessons need to be learned?](#), December 2023, The Law Gazette

⁷³ [Why law firms need to do third-party risk management](#), July 2023, Venminder

⁷⁴ [Risk Outlook report: information security and cybercrime in a new normal](#), June 2022, Solicitors Regulation Authority

⁷⁵ [Protect your firm: understanding the cyber exclusion within your professional indemnity insurance](#), August 2024, The Law Society

⁷⁶ [Seven in 10 firms don't have cyber insurance](#), July 2023, The Law Society

⁷⁷ [Cyber insurance and the legal profession](#), January 2024, The Law Society

⁷⁸ [Cyber Security – A thematic review](#), September 2020, Solicitors Regulation Authority

Insights from sector experts

The insurance expert we spoke with highlighted the importance of standalone cyber insurance, and noted their concern regarding the lack of this across a large number of law firms. They recommended an educational exercise to tackle the false belief that cyber-attacks are covered within traditional PII cover. They further suggested that it would be worthwhile for the SRA to consider making additional cyber cover mandatory for all law firms, as an additional requirement to PII – although recognising that this does come at an additional cost to firms.

4.2.5 Technological advancements

Context

Numerous technological advancements are taking place in the legal sector, which have improved efficiency and the quality of service provision. Firms have adopted digital tools such as interactive dashboards and chatbots on websites, electronic billing software and automated document checking.

The use of artificial intelligence (AI) has also become increasingly common in the legal sector. Service providers now rely on AI for a range of activities (including administration, drafting and profiling, and research and data analytics) to improve productivity and alleviate demanding workloads⁷⁹.

Implications

The LCSP finds that the majority of consumers surveyed value digital services (70% noted digital legal services make it easier to fit into their schedules, and 66% said they increase accessibility)⁸⁰, particularly following the COVID-19 lockdowns⁸¹.

Law firms, especially large corporates, may invest in emerging technologies like AI to remain competitive in the market⁸². Failure to keep up with technological advancements due to constraints in finances, staff capacity or time may negatively affect firms' service and cost efficiency. Of the 1,310 legal service providers surveyed by the LSB, 60% agreed that "*their clients expect them to use technology to deliver legal services*". Of the respondents who have developed new or improved services, 89% said that they improved speed of service delivery and 71% reduced cost of delivery⁸³.

⁷⁹ [Law firm AI: insurance considerations](#), June 2024, Lockton

⁸⁰ [Tracker Survey 2023: How consumers are using legal services](#), July 2024, Legal Services Consumer Panel

⁸¹ [Reforming Legal Services: Regulation beyond the echo chambers \(final report of the Independent Review of Legal Services Regulation\)](#), June 2020, Mayson (UCL)

⁸² [Generative AI in the legal industry: The 3 waves set to change how the business works](#), February 2024, Thomson Reuters

⁸³ [LSB survey reveals pandemic-driven tech innovation in law firms and consumer benefits](#), June 2023, Legal Services Board

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However, some technological applications, particularly the use of generative AI, may pose risks around breach, harm, ethics and liability of this technology.

- AI tools may produce biased results if trained with a lack of awareness of bias, or malicious intent.
- Low transparency on how and where information is gathered induces compliance risk.
- AI tools may also be capable of writing phishing emails or malicious codes, which poses significant cybersecurity risks and risks for client money held by law firms (e.g. phishing emails can lead to clients' money being transferred to a different account than that of the intended legitimate recipient)⁸⁴.

Furthermore, without procedures like human oversight over AI generated content, law firms expose themselves to greater risk of errors that may incur costs on clients. For instance, in the US case *Mata v. Avianca, Inc.*, Mata's lawyers submitted evidence drafted with generative AI, which were revealed to be fabricated by AI in court. Due to their lack of proper verification, the lawyers were sanctioned and fined \$5,000⁸⁵.

Third party AI platforms or tools pose even higher risk than in-house AI tools. Firms are likely to have better understanding of tools they develop in-house, thereby making risk management easier. According to Lockton, firms that rely on third party AI may face additional risks (including counterparty risk, such as if the tool stops operating, and security and privacy risks), and may in turn pose higher risk to client money and service delivery⁸⁶.

Insights from sector experts

A legal expert we interviewed agreed that some firms are eager to adopt tools based on generative AI to keep abreast of technological advancements, and this may have the impact of reducing costs for clients as tasks may be performed more efficiently, or at a higher level of quality.

At the same time, the expert acknowledged the risks to clients without safe and responsible implementation of the technology. The legal expert noted that much of the governance surrounding AI development currently sits with firms, as the SRA's approach to regulation is non-prescriptive and broadly guidance based (although requires that legal standards are met, as set out in the proposed national AI strategy⁸⁷). This may well evolve in the short to medium term in line with the broader debates surrounding AI regulation.

The legal insurance expert we spoke with noted that as firms seek to make the most of new technologies, insurers will likely seek evidence on how these firms are adapting to changes

⁸⁴ [ChatGPT – What are the risks to law firms?](#), March 2023, Legal IT Insider

⁸⁵ [Practical Lessons from the Attorney AI Missteps in Mata v. Avianca](#), August 2023, Association of Corporate Counsel

⁸⁶ [Law firm AI: insurance considerations](#), June 2024, Lockton

⁸⁷ [A pro-innovation approach to AI regulation](#), August 2023, Department for Science, Innovation and Technology and Office for Artificial Intelligence

and taking reasonable steps to mitigate against any risks to client money. For instance, firms may consider creating internal AI policies and risk frameworks, establishing monitoring processes for any AI systems, and ensuring that staff are well-trained and that all staff members are aware of any risks arising from the implementation of AI.

4.2.6 Hybrid working

Context

The cost of living crisis and move to hybrid working have increased financial strain and pressures on individuals, which has in turn exacerbated the likelihood of mistakes and fraudulent behaviour within firms.

The evidence suggests that post-pandemic hybrid working has increased workload and pressure for junior lawyers, especially for those in small firms. The Law Society's Practising Certificate holder survey (2023)⁸⁸ found that junior lawyers felt more stressed than their senior counterparts.

The Law Society notes that double standards surrounding hybrid working has also contributed to frustration among junior lawyers who are required to be in the office while their supervisors stay at home. The Law Society's good practice guidance for supervision mentions the benefits of supervisors working in close proximity with supervisees, which may be difficult to replicate in remote supervision. Overlap in the office provides opportunities for informal communication, for junior lawyers to learn from observation, and for supervisors to more easily check in on supervisees' wellbeing⁸⁹.

Challenges to adequate supervision may also be partly attributed to poor training for managers. LawCare's Life in the Law Survey highlighted the lack of supervisory training for managers in law firms, with only 48% of 829 managers surveyed having received training on skills to provide junior employees with support and supervision needed⁹⁰.

According to Kennedys Law, *"this has led to more claims arising from missed court deadlines, delays in registering documents and failure to progress cases and transactions"*⁹¹.

Hybrid working is also one of the factors which may exacerbate the likelihood of internal fraud, where employees may feel they are protected from managerial oversight and emboldened to commit fraud⁹².

⁸⁸ [Our research shows that junior lawyers are less happy, less fulfilled and more anxious. Why?](#), April 2023, The Law Society

⁸⁹ [Supervision: good practice for remote supervision of junior staff and trainee solicitors](#), June 2024, The Law Society

⁹⁰ [New research into lawyer wellbeing makes the case for profession-wide change](#), 2021, Lawcare

⁹¹ [Professional liability report 2023: Trends and future risks](#), July 2023, Kennedys Law

⁹² [Internal fraud: the threat to law firms, and how to prevent it](#), March 2023, Lockton

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The Cifas Internal Fraud Database showed that cases of internal fraud increased by 15% from 2023 to 2024 for all businesses⁹³. The data revealed an 8% increase in dishonest actions, such as a rise in those stealing cash or manipulating accounts, and a 48% increase in people unsuccessfully trying to deceive potential employers, by concealing adverse credit and employment histories to gain access to organisations and businesses.

Implications

Any mismanagement of cases and client funds will reduce the quality of service for clients and have large impacts in some cases where client funds may be of significant value to the client (e.g. life savings). This will also likely increase the number of insurance claims against law firms. While technical or judgement errors are inevitable to some extent, high stress levels are likely to exacerbate the risk of such errors.

A stressed employee is also more likely to suffer from reduced productivity and encounter issues with performance. Lockton noted cases where solicitors have overlooked essential deadlines within files they inherited from colleagues⁹⁴. It also pointed to insurance claims caused by simple mistakes such as failing to register a standard security or missing key clauses from commercial contracts.

For law firms, internal fraud may affect client money in several ways. According to Lockton, this may include theft of client money, misapplication or dishonest investment of client funds, and misrepresentation to clients concerning held funds.

Insights from sector experts

The insurance expert we interviewed suggested that any rise in claims for the SRA's Compensation Fund are likely driven by cases of dishonesty rather than bankruptcy, given that all insurers are required to provide run-off cover for six years in the event of bankruptcy⁹⁵. Despite this, a legal expert we interviewed noted that cases of misconduct of client finances remain anomalies. Even if these take place, *"most cases that get investigated by the SRA are the first and only time the individual has breached"*.

A legal expert we spoke with explained that in general there are a series of checks and balances to ensure that any serious breaches, such as the misuse of client accounts, are escalated to the SRA. For instance, all solicitors are responsible for reporting any dishonest behaviour, and each law firm is required to have a Compliance Officer for Legal Practice who is obligated to report serious breaches to the SRA.

⁹³ [This is fraudscape 2024](#), April 2024, CIFAS

⁹⁴ [Law firms: tackling the dangers of workplace stress](#), October 2023, Lockton

⁹⁵ [Run-off cover](#), January 2024, The Law Society

4.2.7 Consumer complaints

Context

Consumer dissatisfaction with legal services has increased significantly in recent years. Complaints to the Legal Ombudsman have increased by 97% in the last two years, from 4,757 in FY21 to 9,383 in FY23⁹⁶. Conveyancing takes up the largest portion of complaints (roughly one third), followed by other (20-25%) and wills and probate (10-15%).

The primary reasons for complaints include poor communication, delay and failure to progress, and failure to advise. One in ten complaints however referred to the Legal Ombudsman relate to billing complaints, forming one of the most frequent sources of complaint⁹⁷. The Legal Ombudsman notes that these complaints reflect a lack of customer understanding of lawyers' billing structures, due to a lack of consumer engagement with the market and law firms' inadequate communication about pricing⁹⁸.

Consumer complaints are a direct indicator of customer experience, and an indirect indicator of firm quality and performance. Studying websites of 50 law firms of varying sizes, Money Penny found a low level of clarity about legal services offered by firms – 52% do not articulate offerings online, and 58% are not user friendly, either overwhelming users with information or offering too little⁹⁹. The study also found that the majority of firms could improve their online accessibility; 74% do not display their contact number clearly online, 96% offer no online appointment booking, 94% offer no call back service, and 76% do not provide a requests form. Furthermore, 90% do not offer live chat, although consumers now expect this. Similarly, a study from First4Lawyers found that 43% of callers who left a message received no return call and 37% of email enquiries received no reply. Only 37% of law firms monitor online reviews¹⁰⁰.

Implications

Sustained high levels of consumer dissatisfaction risks undermining public trust and confidence in solicitors and law firms, which is at the heart of the legal system and one of the guiding principles which the SRA requires that legal professionals uphold¹⁰¹. As clients rely on their lawyers to navigate complex legal systems, protect their interests, and provide sound advice, a lack of their trust can have negative consequences for access to justice if this results in a lower likelihood of consumers seeking help.

⁹⁶ [Annual trends in complaints accepted and resolved by the Legal Ombudsman](#), last accessed September 2024

⁹⁷ [Common complaints](#) (Legal Ombudsman), last accessed September 2024

⁹⁸ [Update clients on cost increases or face sanctions, lawyers warned](#), November 2023, Legal Compliance Services

⁹⁹ [Legal firms fail to articulate their products and services online](#), April 2023, Legal Futures

¹⁰⁰ [Trust me, I'm a lawyer – Marketing Legal Services in 2023 \(White Paper 2022/2023\)](#), November 2022, first4lawyers

¹⁰¹ [Guidance: public trust and confidence](#), Solicitors Regulation Authority, November 2019

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The 2024 LSCP's Tracker Survey finds that the perception of lawyers and legal professionals is generally positive. 73% of respondents trust legal service providers to tell the truth and have trust in the legal system. Top factors that would increase consumer trust in their providers include being a specialist (88%), being regulated (87%), and explaining things in a way they could understand (85%).¹⁰²

Insights from sector experts

The legal experts we spoke with indicated that law firms do support consumer awareness by making key points of information clear and accessible for their clients. For instance, they may indicate the channels of complaints available to consumers in their client engagement letters and on their websites.

Furthermore, some firms will proactively put in place client feedback processes to regularly check in with their customers.

¹⁰² [Legal Services Consumer Panel Tracker Survey 2024, Legal Services Consumer Panel, March 2023](#)

5 Conclusions

We have identified a broad range of market changes which may pose risks to consumers, in particular to the safety of client money.

Our report highlights the following risk factors relating to client money in the short to medium term.

- **Risk of misappropriation.** Evidence suggests that this risk is heightened when firms face financial difficulty, when employees work under high pressure or when there is insufficient supervision taking place.
- **AI and cyber risks.** These risks are identified as significant and therefore should be considered high priority for legal service providers, as these may have significant and costly consequences for clients of firms of all types and sizes. Our research suggests that there is scope for improvement in preparedness and cyber risk management across the board.
- **Long-term viability of legal firms.** Any risk of firm closure, whether driven by financial distress or structural issues, may put client money at risk, at least in the short term before any claims for insurance or compensation materialise.

The findings highlighted in this research could be strengthened by internal SRA evidence gathering and empirical analysis of secondary data. Analysis of changes to factors including firms' funding models and structures, and solicitor demographics over time, coupled with data on claims from the SRA's Compensation Fund over time, can help understand risk factors in a more quantitative sense. This could then be used to confirm or indeed challenge any trends identified by publications and external commentators.

The SRA could also continue to monitor the developments identified in this report, to check that sustainable and transparent business practices are maintained and that legal firms take appropriate action to mitigate the concerns identified.

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