



Law firm due diligence

The only constant is regulatory change

White paper



Law firms are now exploring new technologies to help protect them against the potential risks or reputational damage that can flow from conducting business with individuals or companies involved in legally questionable or criminal behavior.

Executive summary

At law firms, the evolution in technology-driven due diligence is transforming the intake process for both clients and vendors. In the past, attorneys relied primarily on client- or vendor-provided forms to gather due-diligence information, but those methods are notoriously unreliable and outdated. Law firms are now exploring new technologies to help protect them against the potential risks or reputational damage that can flow from conducting business with individuals or companies involved in legally questionable or criminal behavior.

Using technology for customer risk assessment is nothing new; it's been part of the banking and financial community's DNA for quite some time. In fact, banking and financial institutions are legally and ethically required to verify a new customer's identity and establish whether they are involved in any risky or criminal business activity. Law firms are not subject to the same legal requirements as financial institutions, but they do need to protect themselves against similar business risks. Furthermore, governments around the world are passing legislation that requires attorneys to gather and disclose information about corporate ownership and financial activity — information that has heretofore been protected by attorney/client privilege.

For these and many other reasons, attorneys are now using a new generation of trustworthy resources and software tools to help them gather the information they need to conduct responsible due diligence on new clients and vendors. This report explores how law firms are using their due-diligence tools and resources, the challenges they face, what opportunities might be available to firms through new technological resources, and how firms currently view the adoption and implementation of these new technologies.

For this report, Thomson Reuters® interviewed and surveyed more than 50 legal professionals and top law-firm decision-makers to learn about the current nature of legal due diligence — who conducts it and why, data resources used, screening frequency, etc. — and the extent to which law firms are aware of, and interested in, technology tools that can strengthen and simplify the due-diligence process, from investigations and screenings to cross-departmental data-sharing and regulatory reporting.

The report explores:

- The changing regulatory landscape for law firms
- Due diligence reporting structures within law firms
- Different types of legal due diligence
- Attorney involvement in investigations
- Preferred data sources and search tools
- User satisfaction of current tools
- Screening frequencies and habits
- Siloed vs. centralized data
- Technological enhancements (e.g., real-time data feeds)
- Overlapping data needs and cross-departmental communication
- Improving investigative efficiency and effectiveness
- Evolving processes and workflows

Methodology

In order to understand more about why and how law firms conduct various types of due diligence, as well as how these practices can be improved, Thomson Reuters surveyed more than 50 lawyers in two phases.

The first phase involved in-person interviews with eight senior decision-makers involved in due diligence research and management. The purpose of the interviews was to obtain qualitative information about due diligence as it pertains to a law firm's business model, legal practice, knowledge gaps, and process workflows.

These qualitative interviews were used to inform the second half of the study, which involved an online survey of 50 senior personnel involved in due diligence (e.g., researchers, directors, practice heads) from law firms of all sizes, though the vast majority (43) were from firms with 150+ lawyers. The following report is derived from these responses and includes information from the initial exploratory interviews.

Part I: Due diligence in a law firm: who, what, and why



When law firms conduct due diligence, they are usually trying to gather the information that supports or rebuts a case, or information that helps assess the risks involved in a business transaction or legal matter.

Who conducts law firm due diligence?

Law firms conduct due diligence screening for a variety of reasons, but no matter what department or practice area is involved, the purpose is to identify any legal, financial, or operational risks and/or liabilities facing the firm or its clients before they become a problem.

In most large law firms, requests for due diligence investigations are initiated by the individual practice group that wants the information. Parties involved in litigation are the most common subject of investigations, followed by parties involved in business deals, real estate transactions, or mergers and acquisitions (M&A). All new clients to a firm undergo a standard due diligence screening, as do any new vendors. Law firms also do competitive intelligence, market research, and other forms of due diligence on behalf of clients. And if a client neglects to pay their bill, firms will conduct whatever investigations they need to in order to recover the assets.

After the practice group has identified the target, requirements, and parameters of the due diligence, the request is typically handed over to a dedicated research department, where one or more research specialists conduct the actual investigation. After the results of the investigation are obtained, the research department usually delivers a report to the requesting attorney(s), then follows up on any additional information requests.

It should be noted that due diligence on new clients is typically initiated by the conflict and accounting departments to identify any possible conflicts of interest or criminal involvement and to determine whether the client has the financial capacity to pay. If the client warrants an extra level of scrutiny, however, these investigations can also extend to sanctions lists, denied-party lists, and other databases chronicling international criminal activity of one sort or another.

Types of due diligence

When law firms conduct due diligence, they are usually trying to gather the information that supports or rebuts a case, or information that helps assess the risks involved in a business transaction or legal matter. Different practice areas have their own reasons for conducting due diligence, however, and the lawyers requesting the investigation have differing levels of involvement in the investigations themselves. Some lawyers are highly involved and work closely with researchers, while other firms are more siloed, and lawyer involvement is limited. Moreover, the extent to which senior partners or other firm leaders are involved in investigations depends on the type, nature, and importance of the case or client.

In the context of a law firm, the primary reasons for due diligence screening and investigations are:



Litigation support: Due diligence is used in litigation to collect facts that can help attorneys prepare for and build a case, defend against a claim, or better understand the parties involved in a case. Investigations typically involve document reviews, personal interviews, searches of public databases (e.g., court records, corporate filings, real-estate records, financial records, etc.), correspondence, and digital evidence disclosed during discovery.



Corporate transactions: Almost all corporate transactions involve some form of due diligence to verify the facts and finances related to any given deal. In mergers and acquisitions (M&A) especially, due diligence is conducted by firms representing both the buyer and seller in order to confirm details of a deal, justify valuations, comply with regulations, and uncover any possible problems that need to be addressed or might void a deal. Corporate due diligence can also involve gathering beneficial ownership information in deals involving shell companies or unknown international entities, as well as screening for any criminal activity involving fraud, corruption, money laundering, tax evasion, human trafficking, or other criminal offenses.



Competitive intelligence: When applied to competitive intelligence in a law firm, due diligence can be conducted on behalf of a client (e.g., for business development information) or the law firm itself. Research in this area might involve analyzing new markets for expansion, monitoring market and legal trends, assessing the activity of other law firms, or providing insights and analysis to support strategic decision-making.



Client screening: All new clients and vendors to a law firm, whether companies or individuals, undergo a general screening to verify supplied background information (e.g., identity, professional licensing, corporate status), assess financial stability, uncover criminal associations, and determine if the client or vendor is a good fit for the firm.

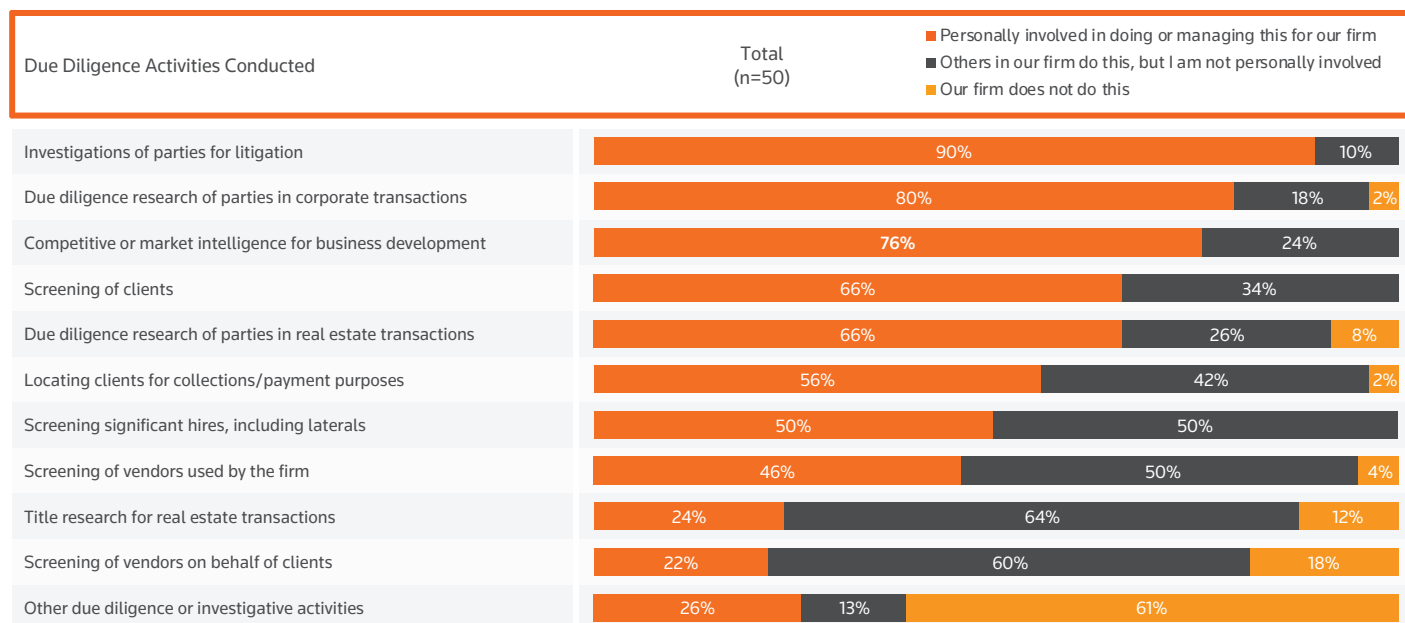


Real-estate transactions: Law firms conduct due diligence to verify information about a property (e.g., title ownership, building permits, zoning, building condition, etc.), its location, market value, property taxes, environmental feasibility, and other relevant factors involved in a real-estate transaction, including the financial stability of the buyer.



Risk assessment: To some extent, all due diligence screenings and investigations in a law firm are about identifying unknown risks, either on behalf of a client or to protect the firm.

Lawyers involvement in due diligence



Lawyer involvement

The degree to which lawyers and senior leaders are involved in due diligence depends largely on the nature and purpose of the investigation. For example, our survey respondents indicate that they have a relatively high level of overall involvement in case-related investigations, and low overall involvement in such administrative tasks as screening vendors or locating clients for payment collection.

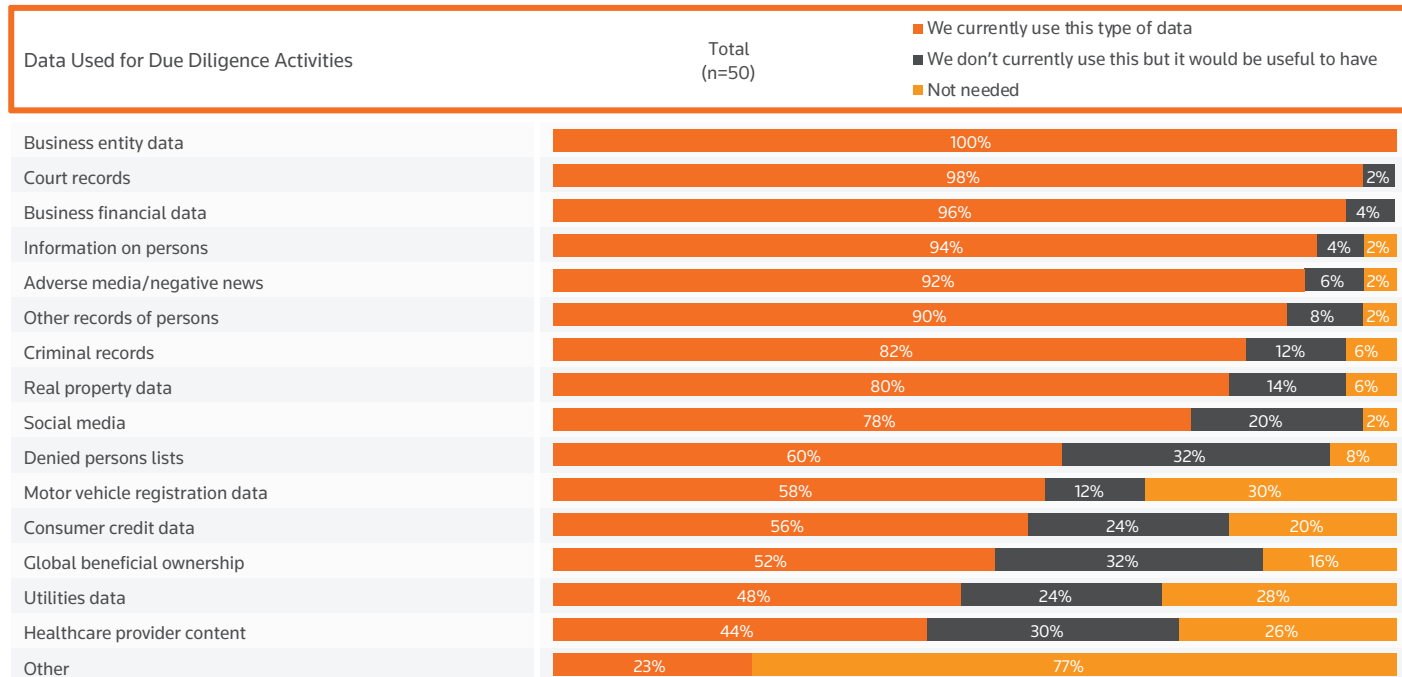
For example, 90% of our survey respondents are personally involved in conducting or managing due diligence when investigating parties for litigation. 80% are involved in doing research for corporate transactions, and 76% get involved in pursuing competitive or market intelligence for business development.

Two-thirds (66%) of survey respondents participate in research for real-estate transactions and client screenings, but involvement tends to drop off if the due diligence does not involve a specific case. For example, only a bit more than half (56%) are involved in locating clients who haven't paid, and less than half (46%) get involved in administrative matters such as vendor screening on behalf of the firm. Even fewer (22%) have anything to do with screening vendors for clients.

In most cases, attorneys who remain involved in the due diligence process are the same ones who requested the research in the first place. At large firms, however, associates are often assigned to oversee research efforts and then act as liaisons to the practice group, communicating progress updates and findings.

Part II: Information sources and usage

Firms use a variety of data sources for due diligence



Data sources

While much due diligence involves reviewing documents and other information supplied by litigants and vendors, it also involves searching for information that isn't provided. This information may have important implications for the case or transaction at hand, but finding it involves searching a wide variety of data sources that may or may not be easily accessible.



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Almost all firms use certain kinds of business and personal data. For example, between 90-100% of respondents to our survey use data on business entities (100%), court records (98%), business financial data (96%), personal information (94%), adverse media/negative news (92%), and other personal records (90%). Somewhat fewer (82%) use criminal records, real-estate property data (80%), and social media (78%), but this still represents a solid majority of law firms.

Information that is harder to obtain is used less frequently, likely because not all firms have the tools or resources to access that type of data. Notably, however, many of our survey respondents indicated that there are certain types of information they would find useful if it were available to them.

For example, 32% indicated an interest in sanctions lists for denied persons and global beneficial ownership (GBO) information on businesses and corporations. 30% said healthcare provider content would be useful information to have, and 24% expressed an interest in consumer credit data and information on utilities.

Some of this data is public — lists for restricted parties, denied persons, and sanctioned parties, for instance — but the lists themselves are cumbersome to use without the help of specialized software tools. Other information — e.g., credit data — can be accessed using tools that draw from proprietary databases and other data sources outside the public domain, but law firms need a legitimate reason for accessing credit data and must in any case adhere to applicable data privacy laws.



Over one-third (36%) of law firms screen more than fifty parties per month. The average number of parties screened was 364.

Screening frequency

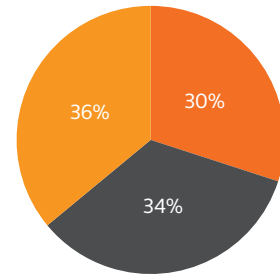
How often a law firm engages in due-diligence screening and monitoring activities may also play a role in how deep they go, given that proprietary investigative tools require more investment than free internet search engines.

When asked about their screening frequency, our survey found that over one-third (36%) of law firms screen more than fifty parties per month. However, the average number of parties screened was 364, which indicates that many law firms are conducting due diligence on several hundred parties, and perhaps thousands, every month.

In any case, conducting some form of due diligence on a daily basis is more the norm than the exception, as roughly one-third (34%) of respondents said they screen 25-50 parties per month, and only 30% screen fewer than 25 per month.

Law firm due diligence frequency

of Parties Screened Monthly (n=50)



■ Less than 25 ■ 25 to 50 ■ More than 50

Average: 364

58% of respondents told us they only re-screen parties when a concern arises

Re-screening frequency

At financial institutions, it is considered a best practice to periodically re-evaluate certain customers as a general protective measure — and an argument can be made that law firms should do the same, for many of the same reasons. However, our survey results suggest that most law firms only conduct follow-up due diligence on a party when they are aware of a potential problem or concern.

Indeed, 58% of respondents told us they only re-screen parties when a concern arises, or they become aware of negative or adverse information that could impact their client or the firm. A small percentage (10%) of firms do make a practice of re-screening at least every six months, and 6% do so annually, but the rest only re-evaluate parties with which they do business every few years at best, and some never do.





As technology advances and more governments around the world try to impose greater responsibility on lawyers to disclose their clients' corporate beneficial ownership information (BOI), law firms may soon be forced to adapt to new regulatory realities.

Many law firms are already considering technology upgrades such as real-time data feeds to enhance their investigative capabilities and better serve both their clients and their firms.

Part III: The future of legal due diligence

The need to adapt

Though law firms conduct many different types of due diligence and use a wide variety of investigative tools, they also tend to rely on similar information sources and conduct investigations and screening on a case-by-case basis, as needed. Most do not have access to the sort of real-time data feeds that financial institutions use, nor do they engage in anything close to real-time monitoring of clients, because they aren't required to — yet.

Law firms may not feel the need for more technological firepower at the moment, but this may soon change. As technology advances and more governments around the world try to impose greater responsibility on lawyers and other financial intermediaries to disclose their clients' corporate beneficial ownership information (BOI) as well as certain other types of information, law firms may soon be forced to adapt to new regulatory realities.

The changing regulatory landscape

In the U.S., for example, the so-called ENABLERS act (Establishing New Authorities for Business Laundering and Enabling Risks to Security) proposes requiring law firms to adhere to the same anti-money-laundering protocols as financial institutions, which would require firms to develop more rigorous due-diligence procedures and report any suspicious financial activity among their clients to the federal government. The bill is currently stalled in the Senate, but the intent of the bill is clear — and, if passed, would require law firms to re-think their due-diligence policies, processes, and technologies.

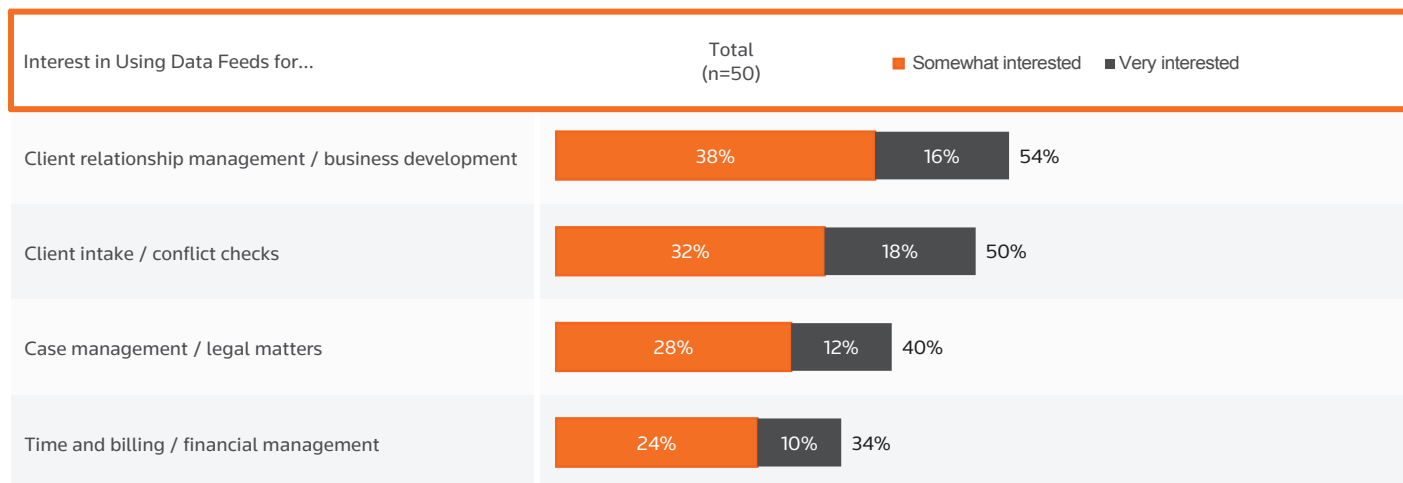
Regardless, the beneficial ownership information (BOI) reporting requirements of the U.S.'s Corporate Transparency Act (CTA) are scheduled to go into effect on Jan 1, 2024. This will impact law firms in several ways. At the very least, law firms will be responsible for advising their clients about BOI requirements and may also be filing this information for their clients. Under the new rule, law firms themselves will have to report BOI, as law firms are considered reporting companies.

More due diligence, more often

A similar legal tussle is occurring in Europe. In November 2022, citing privacy concerns, the European Court of Justice invalidated a provision of a 2018 EU money-laundering directive granting free public access to BOI. However, law firms are still encouraged to cooperate with EU anti-money-laundering efforts, and in the United Kingdom, rules akin to the US's proposed ENABLERS Act are already in place.

As a result of all this legal maneuvering, law firms may soon be required to conduct more types of due diligence, more thoroughly. And if our study is any indication, many law firms are already considering technology upgrades such as real-time data feeds to enhance their investigative capabilities and better serve both their clients and their firms.

Top potential use cases for due diligence data feeds



For example, when asked how interested they would be in integrating real-time data feeds into their existing tech platforms, 54% of survey respondents said they would be somewhat or very interested in real-time data to help manage client relationships and support business development. Half (50%) expressed an interest in real-time data for purposes of client intake and checks for conflicts of interest. 40% saw a use for this type of technology in case management and legal matters, and 34% thought it might be helpful for managing finances and billing.



A disparate, email-based system has significant limitations and perpetuates inefficiencies that simply aren't necessary or productive.

Situations where different departments need the same basic information at the same time are where a centralized database of client information supported by real-time data feeds can be a game-changer.

Data overlap and redundancy reduction

Law firms seeking to upgrade their technological capabilities may also find that adding real-time data feeds to an existing cloud-based system offers several other advantages that a legacy, hardware-based technology framework cannot match.

For example, in one-on-one interviews, law firm leaders and legal professionals revealed that even if their firm has a cloud-based platform, daily workflows for different practice areas and administrative functions (e.g., litigation, transactions, client intake, accounting, conflicts, etc.) still tend to stay within their own distinct silos, except when cross-departmental communication is necessary. And when data needs to be shared, it's usually done by email with documents attached. If approvals are necessary, the documents are emailed around to the appropriate personnel.

Working this way is understandable; it's what people know. But a disparate, email-based system has significant limitations and perpetuates inefficiencies that simply aren't necessary or productive. A more integrated system — one where workflows are channeled through a central data repository — allows attorneys to access the information they need, whenever they need it, from anywhere in the world. Furthermore, client data is more secure in a cloud-based system than it is sitting on an attorney's laptop or on an in-house server.

Breaking down the silos

Another area where a centralized database of client information can be useful is when different practice areas have overlapping data requirements. However, according to our interviewees, most due diligence is conducted in silos and the workflow processes are rarely automated because information tends to be gathered on a case-by-case basis.

Again, situations where different departments need the same basic information at the same time are where a centralized database of client information supported by real-time data feeds can be a game-changer.

For example, the client intake process typically involves at least three departments: Conflicts, Accounting, and Research. All three need similar types of information, including BOI, financial/credit data, records of possible bankruptcies, UCC filings/liens, lawsuits, criminal records (if any), and professional connections and associations. Sometimes, it's also necessary to determine if a potential new client appears on any sanctions or watch lists, or if they are the subject of any negative/adverse media that may impact the firm's decision to represent them.

A centralized database containing this information eliminates the redundancy of separate individuals in different departments searching independently for the same information — which is a much more efficient approach.

For this information to be useful and relevant, however, it must be also as current as possible.

Which is why, again, an automated system supplied with multiple real-time data feeds is so much more sensible than trying to search for the same information manually. Such systems, if properly supported and automated, also ensure that law firms stay up to date on the latest regulations and various watch lists, in both the U.S. and internationally.



The business and regulatory environment in which law firms must operate is rapidly changing, making it necessary to conduct more comprehensive due diligence on new clients and vendors, using more capable technology tools and resources.

Conclusion

The business and regulatory environment in which law firms must operate is rapidly changing, making it necessary to conduct more comprehensive due diligence on new clients and vendors, using more capable technology tools and resources.

Here's why:

- The economic and reputational risk of working with an individual or company involved in questionable or criminal behavior has never been higher.
- Sanctions, denied party, and PEPs lists are constantly changing, making it difficult to stay current.
- Adverse media on clients or vendors in the news or on social media can be damaging in many ways, making continuous monitoring a necessity.
- Regulatory reforms under discussion in the U.S. and around the world are aimed at requiring lawyers to provide more corporate BOI about their clients.
- More comprehensive online search tools and resources now provide attorneys with a wealth of information and data that was unavailable in the past.
- Embracing the tools and technology that enables more thorough due diligence is necessary if law firms want to protect themselves and remain competitive.

Though law firms have come a long way technologically, our research suggests that due-diligence investigations and screenings are an area where many law firms are not taking advantage of the technological capabilities available to them.

At the very least, law firms need to consider using advanced search tools that go far beyond Google and Bing to search court records, real-estate databases, and other publicly available information sources. But to keep up with the accelerating pace of today's information flows, law firms also need access to better, more timely data and consistently updated lists for sanctions, denied parties, and corporate BOI information.

The best way to obtain this type of information is by incorporating automated, real-time data feeds from commonly used sources into an existing, centralized platform. Authorized personnel can then access the necessary information through a secure portal. Such a centralized system also makes it unnecessary for researchers and investigators from different departments to conduct parallel, redundant searches that waste both time and money.



Many large firms have embraced more technologically advanced systems. Those who haven't may soon be forced to play catch-up.

Finally, law firms that resist upgrading the technology and resources necessary for more reliable and thorough due diligence risk falling behind. Because while it's true that many large firms have embraced more technologically advanced systems, many have not. Those who haven't may soon be forced to play catch-up in order to prevent competition, progress, and legislative mandates from overwhelming the limited resources upon which they currently rely.

Next steps for law firms that want to enhance their due diligence capabilities:

- Review the firm's due diligence practices to find out where and how most due diligence is conducted, by whom, and what information resources they are using.
- Identify practice areas and clients/vendors who represent the most risk. How long has it been since they've been vetted?
- Assess the depth and quality of the firm's information resources. Are they adequate?
- Identify information gaps. What additional resources would be most helpful?
- Are your sources current? If not, consider a third-party upgrade — one that includes real-time data feeds, automatically updated watch lists, and corporate BOI information.

[Learn more](#) about Thomson Reuters due diligence solutions.