

# RISKALERT

NOVEMBER 2019 NO 5/2019

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## RISK MANAGEMENT COLUMN

### OVER PAYMENT/INCORRECT PAYMENT SCAM ALERT!

A long-running scam appears to have resurfaced. Communication in respect of the scam was recently distributed by the Legal Practice Council (the LPC) and the Law Society of South Africa (the LSSA) – a copy of the alert can be accessed at <https://lpc.org.za/warning-against-fraud-statement/>.

Put briefly, the *modus operandi* of the scam is that a person purporting to be from the Legal Practitioners' Fidelity Fund (the Fidelity Fund) contacts the legal practice claiming that an amount of money has been paid to the firm. The caller will claim that the amount paid is in respect of a refund for trust account audit fees and/or trust account bank charges and that an overpayment or an incorrect payment has been made to the firm. The phone call may be followed up with an email or fax purporting to be from the Fidelity Fund – a cursory examination of the 'letterhead' used will show that the details (address, phone number, logo and email addresses) are not those of the Fidelity Fund. The type of language used and the numerous typographical errors in the emails or faxes sent by the scammers should also raise a red flag for recipients of the communication.

The caller will inform the firm that the amount was paid in error or



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that there was an 'overpayment' and that a refund should be made into a fraudulent bank account nominated by the caller. In order to induce the firm to act on the misrepresentation, the caller may add that the firm may retain a random portion of the purported payment. In many instances, a fraudulent cheque would have been deposited into the firm's bank account and the caller will put pressure on the firm to make the payment into the fraudulent bank account as soon as possible – the aim is to get the firm to make the payment into the fraudulent account before the

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#### DISCLAIMER

Please note that the Risk Alert Bulletin is intended to provide general information to legal practitioners and its contents are not intended as legal advice.



**Legal Practitioners' Indemnity Insurance Fund NPC**

Est. 1993 by the Legal Practitioners Fidelity Fund



**LEGAL PRACTITIONERS' FIDELITY FUND**

SOUTH AFRICA

## RISK MANAGEMENT COLUMN continued...

discovery is made that the 'deposit' was in fact a cheque that will not be honoured by the bank. In the event that the firm acts on this instruction to pay, it will be out of pocket for the amount paid to the scammers.

As set out in the communication from the LPC, firms should be aware of a few basic points in order to avoid falling victim to the scam. These include that:

- The Fidelity Fund will never contact practitioners by telephone for refunds or use a private email address alleging an overpayment or payment made in error. Payments will also not be made by cheque (the scam artists will give the impression that the 'payment' was made by electronic funds transfer (EFT) and may even send a fraudulent, manipulated document which purports to be a 'proof of payment'). Be aware of emails sent from Gmail, Yahoo and other similar email addresses purporting to be official communication.
- No 'refund' should be made without first verifying the validity of the amount and the ownership of the account into which the funds are to be deposited.
- All staff, and especially those dealing with finance, should be informed and educated about such scams.
- The scammers are very persistent and will be in a hurry to get you to pay the money out immediately knowing that the fraudulent cheque will not be honoured and will be returned marked 'referred to drawer'. In other instances, the scammers may adopt a very friendly and apologetic attitude in order to gain the confidence and sympathy of the person they are dealing with in the firm.

- The Fidelity Fund will not pay trust bank charges/audit fee refunds into the practitioner's trust account but into the practitioner's business account – ask yourself, if the Fidelity Fund were to purportedly pay funds into your trust account, does it become a trust account creditor?

- The amounts of the purported payments bear no relation to the actual refund (if such refund is due to the firm) or the audit fee/trust account banking charge payment cycle.

- The Fidelity Fund should always be contacted directly using the correct contact details (available on the website [www.fidfund.co.za](http://www.fidfund.co.za)) to confirm to confirm the authenticity of any communication asking for payment and to report any suspicious behavior. The telephone numbers for the Fidelity Fund are (021) 424 5351 or (012) 622 3900.

- Before making any payment (whether the Fidelity Fund or any other party) practitioners must verify the account details as prescribed in Rule 54.13.

We can also add that payments (even legitimate payments) should never be made unless and until there is confirmation from your bank that the funds have indeed cleared in your account and the manner in which the deposit has been made (EFT, cheque or cash) accords with what is claimed by the depositor. Questions should also be asked why the purported depositor will offer that the firm can retain part of the funds to which the firm was not entitled in the first place – there would be no legal basis for the firm to retain any of the funds if the payment had indeed been made in error. The 'fee' offered by the scammers is as a means

(a sweetener) to induce the firm to fall for the scam when no such fee is due as the firm has not rendered any legal services in this instance and thus not entitled to any fee.

Practitioners must also keep as much detail as possible of their interaction and communication with the scammers. If possible, the phone calls should be recorded. An information and technology expert may be able to assist you in tracing the email accounts used and will also be able to advise you on how best to preserve evidence that can be used in later court proceedings. Please also report this (and all other scams) to your bank and the South African Police Services (the SAPS).

The Legal Practitioners' Indemnity Insurance Fund NPC (the LPIIF) will not indemnify firms that suffer losses as a result of falling victim to the scam. This loss will be a trading debt (clauses XXVII and 16 (a) of the Master Policy) and not a loss arising from professional legal liability to pay compensation to a third party (clauses 1 and 16). Losses arising from cybercrime are also not covered by the LPIIF policy (see clauses IX and 16 (o)). Firms must implement appropriate internal measures to mitigate against this and other scams. Educating staff on the *modus operandi* and prevalence of scams is an important and effective risk mitigation measure. The purchase of appropriate insurance cover (a commercial crime policy, misappropriation of trust fund cover and fidelity guarantee cover (the latter will apply in cases business account is the target of the scam), for example) is a risk transfer option that the firm can also consider.

In the event that the firm falls victim to the scam, resulting in a shortfall in the trust account, there is a responsibility on the practice to notify the LPC as

## RISK MANAGEMENT COLUMN continued...

prescribed in the rules issued in terms of the Legal Practice Act 28 of 2014 (the Act). The relevant rules provide that:

***Trust moneys not to be less than trust balances***

*54.14.8 A firm shall ensure that the total amount of money in its trust banking account, trust investment account and trust cash at any date shall not be less than the total amount of the credit balances of the trust creditors shown in its accounting records.*

***Trust accounts not to be in debit***

*54.14.9 A firm shall ensure that no account of any trust creditor is in debit.*

***Reports to Council of non-compliance***

*54.14.10 A firm shall immediately report in writing to the [Legal Practice] Council should the total amount of money in its trust bank accounts and money held as trust cash be less than the total amount of credit balances of the trust creditors shown in its accounting records, together with a written explanation of the reason for the debit and proof of rectification.*

*54.14.11 A firm shall immediately report in writing to the Council should an account of any trust creditor be in debit, together with a written explanation of the reason for the debit and proof of rectification.*

Vigilance at all times and the implementation of a risk management culture will assist firms in avoiding this and other scams.

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## GENERAL PRACTICE

### FIDELITY FUND CERTIFICATE APPLICATION PERIOD OPENS

**T**he application period for Fidelity Fund certificates for the 2020 year commenced on 1 October 2019. Practitioners liable to apply for Fidelity Fund certificates (sole practitioners, partners or directors and advocates practising with trust accounts in terms of section 34(2) (b) of the Legal Practice Act 28 of 2014 (the Act)) are urged to keep a look out for communication from the Legal Practice Council (the LPC) regarding their applications for Fidelity Fund certificates. Practitioners are advised to go to the LPC website (<https://lpc.org.za/>) or to that of the Legal Practitioners' Fidelity Fund (the Fidelity Fund) (<http://www.fidfund.co.za/register-your-business/fidelity-fund-certificate-applications/>) for information regarding the

Fidelity Fund certificate application process and the requirements to be met by applicants.

The obligation to be in possession of a Fidelity Fund certificate arises from the Act. Section 84 of the Act provides as follows:

**Obligations of legal practitioner relating to handling of trust monies**

*84. (1) Every attorney or any advocate referred to in section 34(2) (b), other than a legal practitioner in the full-time employ of the South African Human Rights Commission or the State as a state attorney or state advocate and who practises or is deemed to practice —*

*(a) for his or her own account either alone or in partnership; or*  
*(b) as a director of a practice which is a*

*juristic entity, must be in possession of a Fidelity Fund certificate.*

*(2) No legal practitioner referred to in subsection (1) or person employed or supervised by that legal practitioner may receive or hold funds or property belonging to any person unless the legal practitioner concerned is in possession of a Fidelity Fund certificate.*

*(3) The provisions of subsections (1) and (2) apply to a deposit taken on account of fees or disbursements in respect of legal services to be rendered.*

*(4) A Fidelity Fund certificate must indicate that the legal practitioner concerned is obliged to practise subject to the provisions of this Act, and the fact that such a legal practitioner holds*

## GENERAL PRACTICE continued...

*such a certificate must be endorsed against his or her enrolment by the [Legal Practice] Council.*

*(5) A legal practitioner referred to in subsection (1) who —*

*(a) transfers from one practice to another; or*

*(b) ceases to practise,*

*must give notice of this fact to the [Legal Practice] Council and comply with the Council's relevant requirements in relation to the closure of that legal practitioner's trust account and in the case of paragraph (b) return his or her certificate to the Council.*

*(6) The Council may withdraw a Fidelity Fund certificate and, where necessary, obtain an interdict against the legal practitioner concerned if he or she fails to comply with the provisions of this Act or in any way acts unlawfully or unethically.*

*(7) The provisions of this section do not apply to a legal practitioner who practises in the full time employ of Legal Aid South Africa on a permanent basis.*

*(8) An advocate, other than an advocate referred to in section 34(2)(b), may not receive or hold money or property belonging to any person in the course of that advocate's practice or in respect of any instruction issued to the advocate by an attorney or a member of the public.*

*(9) No legal practitioner in the full-time employ of the South African Human Rights Commission or the State as a state attorney, state advocate, state law adviser or in any other professional capacity may receive or keep money or property belonging to any person, except during the course of employment of such legal practitioner with the State or the South African Human Rights Commission and in such case only on behalf of the South African Human Rights Commission or the State and for no other purpose.*

Section 85 of the Act (read with rules 47, 48 and 49) sets out the procedure for the application for a Fidelity Fund certificate. The offences and penalties for contravening section 84 of the Act are set out in section 93 (8) which provides that:

*(8) Any person who contravenes sections 84(1) or (2) or section 34, in rendering legal services —*

*(a) commits an offence and is liable on conviction to a fine or to imprisonment for a period not exceeding two years or to both such fine and imprisonment;*

*(b) is on conviction liable to be struck off the Roll; and*

*(c) is not entitled to any fee, reward or reimbursement in respect of the legal services rendered.*

Practitioners must thus ensure that they apply for their 2020 Fidelity Fund certificates timeously and that they comply with all the requirements for the granting of such certificates.

In the December 2018 edition of the *Bulletin* (accessible at [https://lpiif.co.za/wp-content/uploads/2019/04/RAB\\_December-2018\\_WEB.pdf](https://lpiif.co.za/wp-content/uploads/2019/04/RAB_December-2018_WEB.pdf)) we reported on the judgement delivered by the Limpopo Division of the High Court in **NW Civil Contractors CC v Anton Ramaano Inc and Another** (993/2016) [2018] ZALMPHC 1 (14 May 2018). In that matter, the Limpopo High Court, considering the provisions of the Attorneys Act 53 of 1979, held that the actions of an attorney who practiced without a Fidelity Fund certificate, when obliged to be in possession of such a certificate, were *void ab initio*. That judgment has been taken on appeal and the matter was argued before the Supreme Court of Appeal on 3 September 2019. The LPIIF's application to be admitted as *amicus curiae* in this was granted by the SCA. Legal argument was advanced by the LPIIF on the issues for determination by the SCA. The SCA, in a

judgment handed down on 14 October 2019, found that the relief granted by Phatudi J was never sought nor pleaded. The court confirmed that section 41 (1) of the Attorneys Act prohibited a practitioner from practising or acting as such without being in possession of a Fidelity Fund certificate. A copy of the SCA judgment can be accessed at [http://www.justice.gov.za/sca/judgments/sca\\_2019/sca2019-143.pdf](http://www.justice.gov.za/sca/judgments/sca_2019/sca2019-143.pdf).

The LPIIF will not indemnify practitioners who, in violation of the Act, practice without a Fidelity Fund certificate. In order to qualify for indemnity under the LPIIF policy, the principal/s in the practice – defined in the policy as an advocate referred to in section 34 (2) (b) of the Act, sole practitioner, partner or director of a legal practice or any person who is publicly held out to be a partner or director of a legal practice (see clause XXIII) — must, on the date that the cause of action giving rise to the claim arose, have had a Fidelity Fund certificate (see clauses 5 and 6 of the policy). Practice conducted in violation of the provisions of the Act and the rules is not indemnified by the LPIIF (clause 16 (t) of the policy). In the event that the firm has placed top-up insurance cover (professional indemnity insurance in excess of the primary layer provided by the LPIIF) or any of the insurance products available in the commercial market, practitioners must have regard to the wording of those respective policies in order to assess whether or not they will be entitled to indemnity (and to what extent) in the event of a claim where the cause of action arose when there was no Fidelity Fund certificate. It is thus prudent that practitioners liable to apply for Fidelity Fund certificates do so timeously in order to ensure that there is no break in the period between one Fidelity Fund certificate and the next one.



## GENERAL PRACTICE continued...

### CLAIM STATISTICS

#### THE LPIIF CLAIM STATISTICS

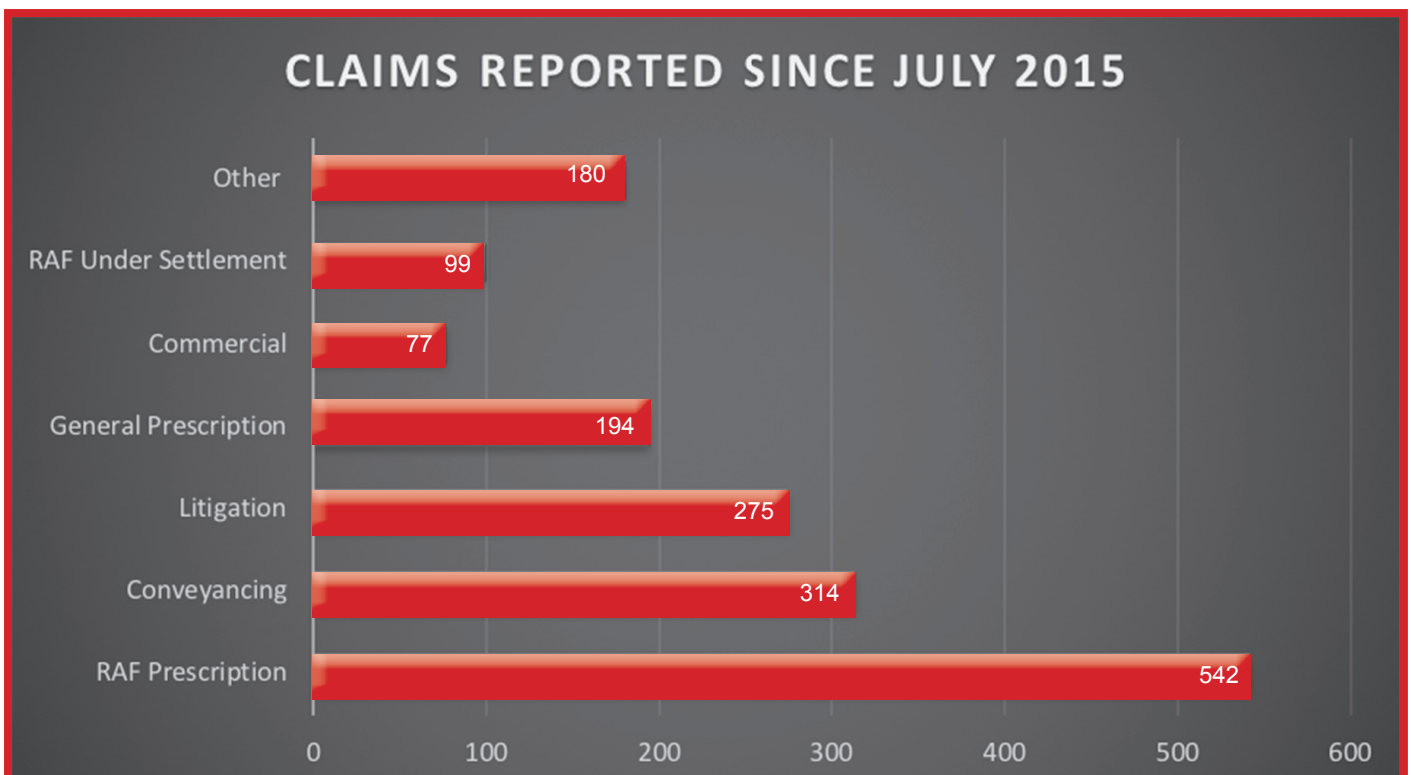
At the end of the 2018/2019 financial year on 30 June 2019, outstanding professional indemnity claims notified to the Legal Practitioners' Indemnity Insurance Fund NPC (the LPIIF) were actuarially calculated

at R565, 559, 300. This represents a 7% increase in just one quarter when compared to the corresponding figure as at the end of March 2019. Outstanding professional indemnity claims of over half a billion rand must be a cause

for concern for all stakeholders in the South African legal profession.

The main claim types have remained constant in the last four years as will be noted from the table 1 below:

**Table 1**



Claims arising out of the prescription of matters pursued against the Road Accident Fund (the RAF) make up the highest number by far. This is despite the efforts of the LPIIF in highlighting this risk to the profession and the making of the Prescription Alert system, as a backup diary system, available to the profession. On average, RAF related claims, by their nature, are also the most expensive claim type for the LPIIF both in terms of the value of the quan-

tum paid in respect of such claims but also in terms of the amount spent on investigation and defence costs.

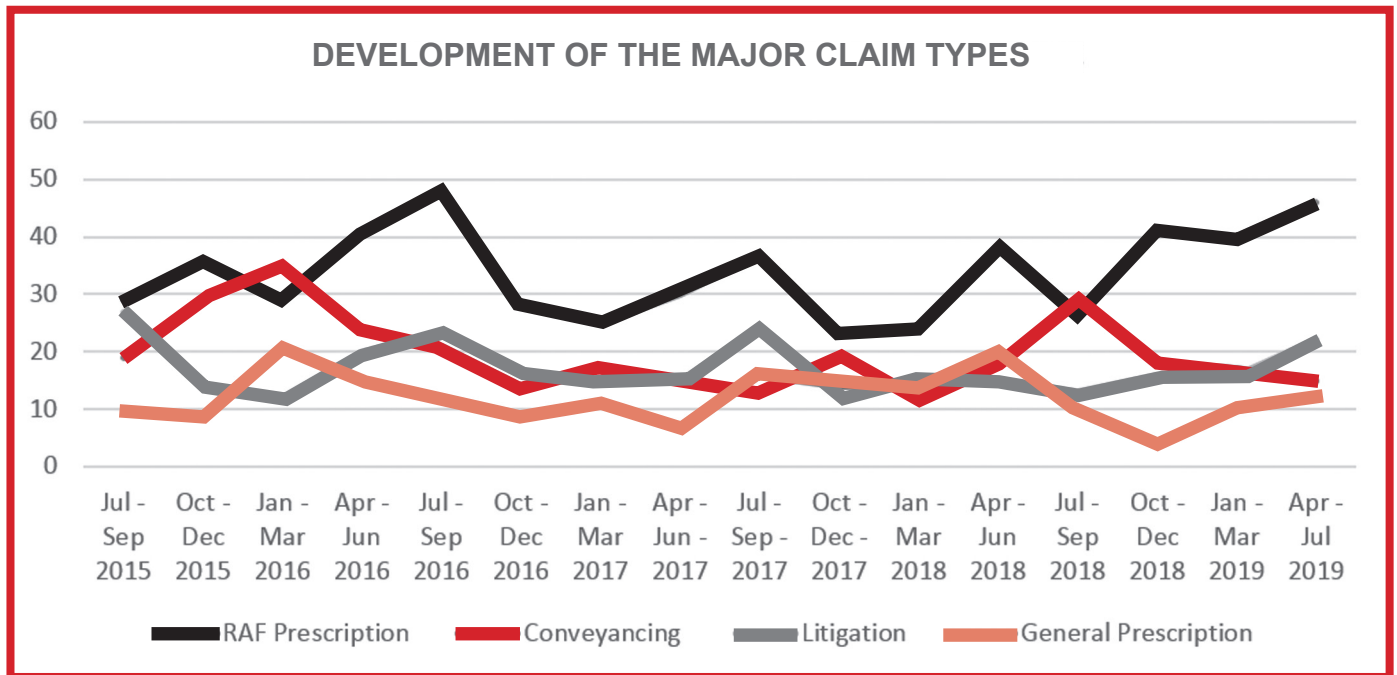
We have also published a number of suggestions for practitioners to consider implementing in their firms in order to mitigate the risk of prescription. In prior editions of the *Bulletin* we have also highlighted several legal arguments that practitioners can consider advancing, in appropriate cir-

cumstances, in order to challenge the prescription point raised by the RAF.

Breaking the claim notifications down into quarterly intervals, it will be noted that an average of just under 50 prescribed RAF claims are being notified per quarter as will be noted from table 2 on the next page. This shows the constant frequency and severity of the risk associated with the prescription of RAF claims.

## GENERAL PRACTICE continued...

Table 2



In so far as conveyancing claims are concerned, the peak noted just before July 2016 mainly related to cybercrime claims. Claims related to cybercrime were excluded from the LPIIF Master Policy (see clause 16(o)) with effect from 1 July 2016. The number of cybercrime related claims notified to the LPIIF since the exclusion came into effect now stands at 143 (an increase of 6,72 % in number since the last quarter and a corresponding increase of 6% in the value of such claims notified). Despite the large amount of communication from various sectors regarding cyber risk, phishing scams and alerts directed to the profession regarding the prevalence of emails purporting to give instructions to change beneficiary banking details, the warnings have gone unheeded in many instances unfortunately.

Though cybercrime related claims are now excluded from the LPIIF policy, practitioners falling victim to this type of crime are urged to report these matters to the South African Police Services (the SAPS) and to provide the LPIIF with details of the criminal cases opened so that we can have a record of all such

cases. As with the scam referred to on page 1, practitioners must also retain as much information and evidence as possible relating to cybercrime related matters. Working with a number of other stakeholders, the LPIIF is making efforts to have the cybercrime related matters investigated and prosecuted by the SAPS and the National Prosecuting Authority (the NPA) in a coordinated manner. In order to convince the authorities of the importance of establishing such a project, we will need as much information on each and every cybercrime incident as possible.

We are aware of the challenge faced by some practitioners in certain parts of the country where the SAPS members may either refuse to register the case (on the basis that it is purportedly a civil matter), the difficulties in getting certain law enforcement agents to understand the nature of this crime and the *modus operandi* used or to get the SAPS members to put an effort into the investigation - we have been informed that in some instances the officers registering the cases have asked the practitioners who have fallen victim to the

cyberscams whether they are merely reporting the matters for insurance purposes. In many instances, the scam targeting legal practitioners is part of an organised criminal enterprise with international links. The perpetrators of the scam must be identified, investigated and prosecuted and, where possible, action must be taken to recover the funds lost by the victims. The cooperation and efforts of the profession and all other stakeholders are required in this regard.

### FIDELITY FUND CLAIM STATISTICS

In the period from 1 July 2018 to 1 July 2019, the Fidelity Fund had received 866 claims with a combined value of R420, 009, 920. The Fidelity Fund's potential liability stands at R389, 182, 912 in respect of these claims.

Tables 3 and 4 on the next page show the number and value of claims notified to the Fidelity Fund and the value of claims paid, respectfully, in the last decade. The Fidelity Fund claims statistics relate to misappropriation of

## GENERAL PRACTICE continued...

Table 3

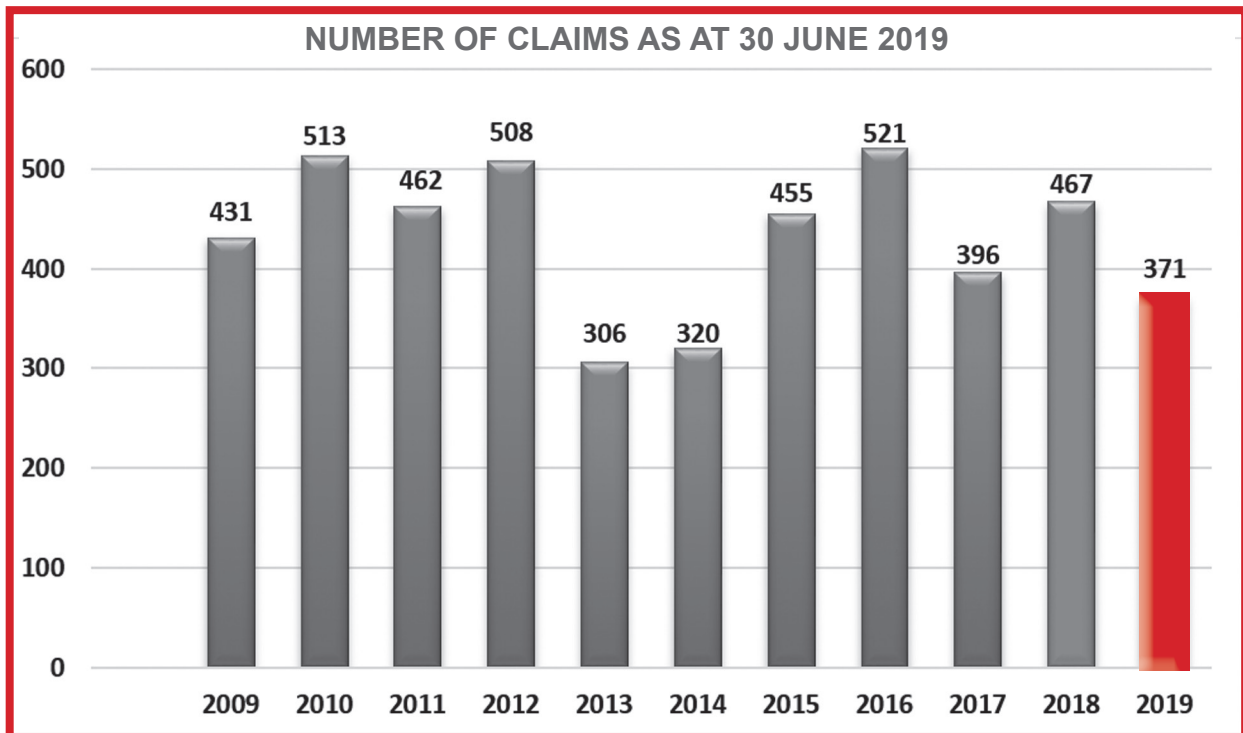
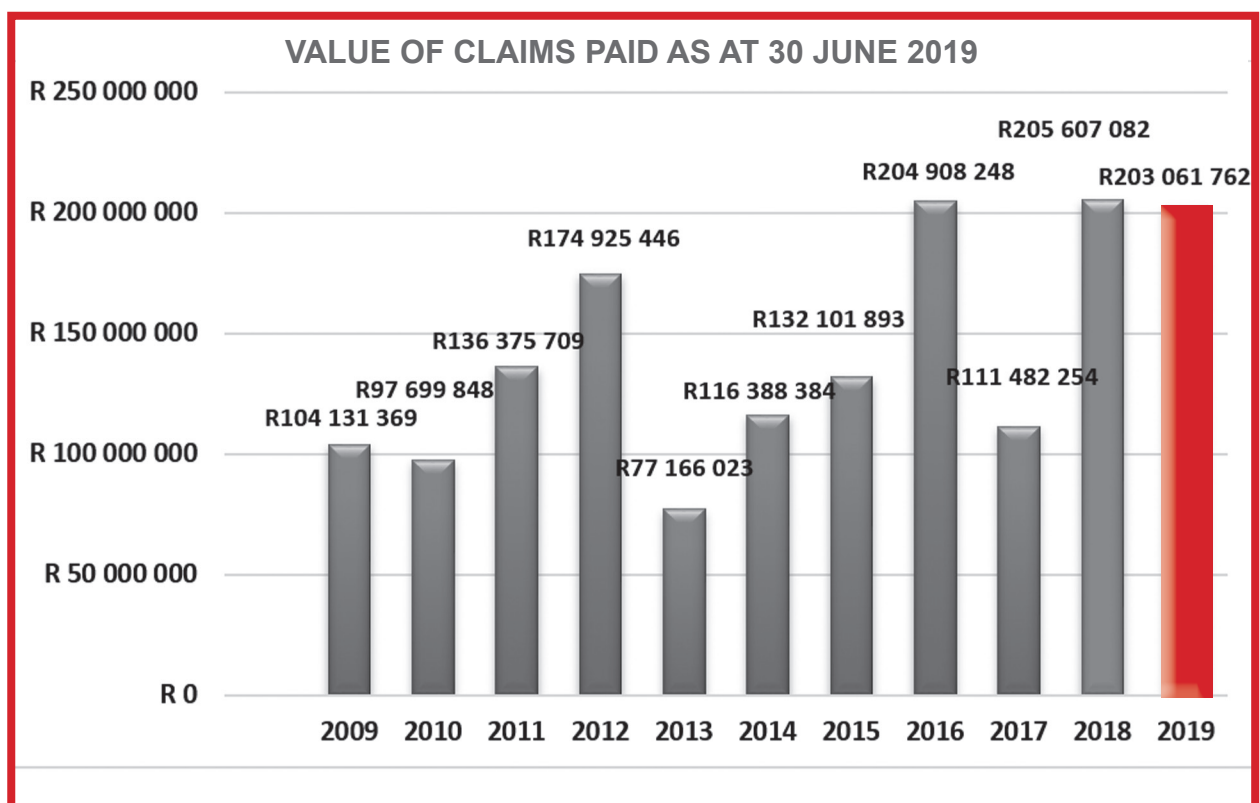


Table 4



## GENERAL PRACTICE continued...

trust fund claims.

### Contingent claims

As at 30 June 2019, the Fidelity Fund had 1242 claims on record with a total value of R695, 108, 856. As will be noted from table 5 below, misappropriation of trust fund related claims occurs mainly in the areas of conveyancing, Road Accident Fund (RAF) claims and the administration of estates. (The claims falling into the 5% category (other) arise from administrations, collections, work in the area of criminal law, matrimonial matter and insolvencies.)

As with any other business enterprise, law firms face a number of internal and external risks in so far as the protection of funds are concerned. For law firms this is compounded by the fact that, in the nature of legal practice,

funds belonging to third parties are received and paid. Firms must thus develop and implement the appropriate internal controls over their financial functions as prescribed in the rules. In addition thereto, legal practices should also strive to ensure that best practices are developed and implemented in the financial areas of their operations.

Rule 54.19 provides that:

#### **Responsibility for ensuring compliance**

*54.19 Every partner of a firm, and every director of a juristic entity referred to in section 34(7) of the Act, and every advocate referred to in section 34(2) (b) of the Act, will be responsible for ensuring that the provisions of the Act and those of the rules relating to trust accounts of the firm are complied with.*

The ultimate responsibility (and liability for) losses resulting from the theft

of trust funds lies with the partners or directors in the legal practice- in the case of an advocate practising with a trust account, the responsibility and liability will lie with the practitioner concerned. Directors of juristic entities conducting legal practice in terms of section 34 (7) are jointly and severally liable with the juristic entity, *inter alia*, in respect of any theft committed during their period of office (section 34 (7) (ii)).

As will be noted from the statistics published above, the misappropriation of trust funds is, unfortunately, widespread and the quantum of the funds involved are very high.

Practitioners must develop and implement appropriate measures in their practices to mitigate against this risk.

**Table 5**

