Special Reprint (Jan/Feb 2005)

NSCP CURRENTS

A Publication of the NATIONAL SOCIETY OF COMPLIANCE PROFESSIONALS

Balancing the roles of CCO and Legal Counsel

By Michelle L. Jacko

This communication reflects the personal thoughts of the author and not that of LPL Financial Services or its affiliated persons.

You've just been offered an exciting opportunity at a reputable investment advisory firm to serve as the Chief Compliance Officer and Legal Counsel. This is the position that you have long-desired – to combine two "hats" into one position. As you enter the office on your first day, there are some important factors you should consider, especially when developing your legal/compliance and training program.

Q: What are some of the "best practice" tips for those individuals who wear dual hats as both an investment advisory firm's Legal Counsel and Chief Compliance Officer (CCO)?

A: Under the Compliance Program Rule,[1] the Securities and Exchange Commission (SEC) clarified that the CCO does not only have to be responsible for compliance but may wear dual hats.[2] Particularly for those smaller advisory firms, it is not uncommon to have a person act as both CCO and Legal Counsel. The challenge you may face is discerning roles and responsibilities surrounding various facts and circumstances. Below are some of the most common situations where these lines could and do become blurred and guidance on how to define roles, what to say and when to say it.

1. Correspondence and E-mail Communications

The new SEC examination program typically requires advisory firms to produce certain correspondence and e-mail communications to the Staff during an examination. During document production, your firm will need to decide if they wish to hold the attorney-client privilege or waive it. If the privileged is held, your firm will be required to produce its privilege log that contains the reason why certain communications are privileged.

A frequent presumption is that any correspondence sent to or by in-house legal counsel is privileged. Reputably, in order to assert the privilege, the communication should reflect the intention that it is being made in confidence and protected from disclosure to third parties whose inclusion is not necessary to further the firm's interests. For the privilege to apply, the attorney must be acting in a counseling capacity, not as a business advisor, negotiator or note taker. Therefore, this can present particular difficulties when the attorney is in-house counsel, and especially if you have a dual role as CCO, who acts as a business advisor.

To help firmly assert the privilege, the firm must ensure that the communication is in furtherance of legal advice, and not the protection of underlying facts.[3] Furthermore, in-house counsel must clearly delineate the role of counsel versus CCO, particularly when asserting the

(Continued on page 2)

 Michelle L. Jacko is Vice President of Compliance at LPL Financial Services.

CCO AND LEGAL COUNSEL
(Continued from page 1)

privilege in documentation. To help clarify and establish your intentions, in-house counsel privileged communiqués should proactively begin with:

SUBJECT HEADING: Attorney-Client Privilege Information
MESSAGE: "As Legal Counsel of this firm, I wish to advise on……."

Having your role and intention communicated at the onset helps clarify to the recipient (including, the regulators who may review the communication) your role and responsibility for that correspondence. Moreover, should you decide to claim the privilege during a regulatory examination, using the above format may assist in your electronic searches to segregate any correspondence that has "Attorney-Client Privilege" in the subject heading.

2. Due Diligence Meetings

When conducting due diligence meetings, be sure to inform the participants which hat you are wearing. As counsel, your focus may be on issues that the CCO would not traditionally concentrate on, such as contracts, disclosures, solicitations and other representations made. As issues arise during these meetings, you may need to contact outside counsel for advisement, which again may trigger the attorney-client privilege. In these situations, it is important to be sparing on how communications subject to the privilege are shared within the company. Be careful of freely distributing these communications "for information." Instead, treat privileged communications as you would the company's information security policy and procedures that is subject to the highest level of security ordinarily used. It is important for you, as Legal Counsel, to provide training to upper management, and others about the attorney-client communication, concentrating on how to protect the privilege. (For example, send written communications in tamper-evidence envelopes marked "confidential.")

As CCO, your focus during due diligence meetings may be more on business relationships and matters such as performance numbers, operational issues and roles and responsibilities. If you are affiliated with an investment company, the CCO may be conducting its own due diligence of service providers as part of the firm's compliance program.[4] This may furthermore require you to draft a summary for the fund board, focusing on material changes to the fund and/or service provider's compliance policies and procedures. In this evaluation, the CCO may also want to provide recommendations on how to enhance the procedures to address any potential "gaps" that are uncovered and keep that gap analysis privileged. To assist, you may want to (1) hire outside counsel to ask for legal advice or (2) wear your hat as in-house counsel, which may be difficult to do. To protect the firm, ask colleagues to include in communications the header, "confidential attorney-client communication requesting legal advice." While not full proof, this approach helps to preserve the secrecy needed for confidentiality and reduces the implication that as in-house counsel you're acting as a businessperson rather than a counselor for legal advice.

3. Regulatory Examinations

Under the new SEC examination program, the Staff is requesting firms to disclose any material violations and repeated minor violations as part of the initial documentation request. As you test your compliance program as required under the new Rule[5], you presumably are acting as CCO and not as Legal Counsel. Therefore, remember that findings and results of the annual review are not necessarily privileged.

If you wish to have the testing done under the protection of privilege, as in-house attorney you may wish to obtain outside counsel who can hire an independent third party to test your compliance program. That way outside counsel may advise you in privileged communications as to any potential or actual violations of securities laws by your firm. But be warned – this privilege is not absolute. In litigation, even if your firm succeeds in showing that it applied the privilege and the privilege was not waived, a legal tribunal may, nonetheless, disregard it and compel you to

disclose this information.

In conclusion, as you are testing your compliance program, drafting e-mails and preparing documents for a regulatory examination, you may face challenges in helping the regulators and others understand what roles and responsibilities you have as Legal Counsel and CCO and under which circumstances they apply. By clarifying your communications with certain disclosures, training staff and outlining your roles and responsibilities within your firm's policies and procedures manual, you can serve as CCO and Legal Counsel with clarity of vision for all parties. ❑

1. *See* Rule 206(4)-7 under the Investment Adviser's Act of 1940 and Rule 38(a)-1 under the Investment Company Act.
2. *Id* at page 40. (With emphasis, *"The rule does not require advisers to hire an additional executive to serve as compliance officer, but rather to designate an individual as the adviser's chief compliance officer.")*
3. For example, copying in-house counsel on an e-mail does not prevent the discovery and admission of facts contained in the e-mail.
4. Rule 38a-1 requires fund boards to approve the policies and procedures of fund service providers and to oversee compliance by its service providers.
5. Rule 206(4)-7 and 38a-1 requires annual review of the firm's policies and procedures to determine their adequacy and effectiveness of implementation.

NSCP CURRENTS

is published by the
National Society of Compliance Professionals, Inc.
22 Kent Road, Cornwall Bridge, CT 06754
(860) 672-0843 / info@nscp.org