

■ Reluctant COLPs: how prepared are they for the problems ahead?

Peter Scott and Stephen Ralph

When the new appointees take up their posts in the New Year, they will need to balance their responsibilities to their firms and to the regulator. No easy task, but it can be done

The role of the compliance officer for legal practice (COLP) is said by the Solicitors Regulation Authority (SRA) to be the key to the new regulatory regime. The approvals process by the SRA is in progress and the countdown has begun towards 1 January 2013 when COLPs must take up their roles. There is now only a small window available for firms to put in place all the necessary arrangements to enable their COLPs to fully and effectively carry out the role. The nomination forms for both COLP and compliance officer for finance and administration (COFA) should have been submitted by 31 July 2012 and firms will be notified in terms of approval or otherwise by 31 December 2012. The nomination form provides that in preparation for completion of the form the authorised signatory of the firm must ensure that the firm and the nominee(s) have read and understood the regulatory provisions to be found in:

- rule 8.5 of the SRA Authorisation Rules;
- regulation 4.8 of the SRA Practising Regulations; and
- the SRA suitability test.

However, have firms (and the SRA) really thought through the practical considerations of how the COLP role will be carried out, and in particular the impact which effective performance of the COLP role is going to have on the way a firm operates internally and on relationships within a firm?

In particular, is conflict likely to arise in firms as a result of the COLP performing the role, where is the conflict likely, and in respect of which issues could conflict occur?

In this article, from our experience of the management of law firms and of disputes over many years, we examine the potential for such conflicts and the possible steps which firms and COLPs should now take to ensure that the COLP will be able effectively to fulfil the role and, if a conflict does arise, how the position of the COLP can be protected.

The 'independent' role of a COLP

The SRA Authorisation Rules 2011 require the appointment of the COLP and para. 8.5 provides that a firm must have 'suitable arrangements in place to ensure that its compliance officers are able to discharge their duties in accordance with these rules'.

The SRA has to approve an individual's designation as a COLP and must be satisfied that the individual is a suitable person to carry out his or her duties. The criteria for approval are set out in rule 15 of the Authorisation Rules and refer to the SRA suitability test. The guidance notes provide:

'(1) As well as evidence about the candidate, the Suitability Test takes into account evidence about the honesty and integrity of a person that the candidate is related to, affiliated with, or

acts together with where the SRA has reason to believe that that person may have an influence over the way in which the candidate will exercise their role.'

A COLP must be and has to be seen to be independent and be able to act independently. We initially had concerns regarding these words, in particular as to the suitability and independence of someone in an existing Management Team, and the extent to which such a candidate would be able to function independently of Management. Here, our reference to 'Management' and 'Managers' is with a capital 'M' and is not a reference to managers as defined in the SRA Handbook Glossary 2012 as; *'(i) a member of an LLP; (ii) a director of a company; (iii) a partner in a partnership; or (iv) in relation to any other body, a member of its governing body'*.

The genesis of rule 15 of the Authorisation Rules and the SRA Suitability Test 2011, part 2, is the Legal Services Act 2007, Sch. 13, and was brought into being as part of the regulation of alternative business structures (ABSs) where third parties other than lawyers would have interests in a firm. The need to ensure that the compliance officer in an ABS is independent, and able to be independent of non-lawyer third parties, is wholly understandable and appropriate.

Is conflict likely to arise in firms as a result of the COLP performing the role?

This issue was referred to in a speech given in December 2011 by Samantha Barrass, executive director of the SRA, when she said:

'On this, and looking at the heavy representation from larger firms in the audience, I would also caution against making your Senior or Managing Partner your COLP. Over the summer there seemed to be a lot of fear and loathing around these roles, for reasons I hope I have now laid to rest, with a few – but by no means all – suggesting that only a Senior or Managing Partner could take it on. It's entirely up to you of course – we're not prescriptive. But a lot of you will be in the Relationship Management approach to supervision, with a lot of engagement with us. We will expect to meet regularly with the COLP and for that person to be completely on top of risk and compliance management in your firm. A titular COLP will not be acceptable. If you think your Senior or Managing Partner can take on this role – then fine! But please make sure they go into it with their eyes wide open and will have the time to devote to the job.'

We do not, however, consider that the 'independence' requirement will or should necessarily rule out a COLP being a member of the Management Team of a firm. Indeed, it is likely

to be in many firms, not only small firms, the only workable solution. The independence requirement is, we would suggest, more the need to maintain independence of role of the COLP, whether from the Management Team (if a COLP is not part of Management) and/or from 'managers' as defined, namely members/directors/partners.

Perhaps a more cogent reason for not having a managing partner as the COLP is that it is likely that a managing partner will have too many other demands on his/her time and will not be able to effectively carry out the role. Samantha Barrass seems in her speech to be questioning whether a managing partner in a large firm would have sufficient time to devote to the role, but, as she also says, 'It is entirely up to you.'

A conundrum which many firms have most probably had to face when nominating their COLPs is that the person most likely to be able to ensure compliance by everyone in the firm with all the principles, outcomes and other requirements of the SRA Handbook, will be the managing partner.

It will be interesting to see whether, during the approvals process now being undertaken, the SRA questions the suitability of some managing partners for the role as COLP.

If a COLP is not part of Management, we suggest that for the COLP to be able to comply with his/her obligations it will be necessary for the COLP to be fully informed of Management decisions prior to their implementation. This may require the COLP to attend Management/board meetings, otherwise the COLP will not have sufficient relevant knowledge of what is happening in the firm, and having such knowledge is necessary if a COLP is to fulfil the role effectively. We suggest that, at the very least, the COLP is provided with comprehensive minutes of initial decision-making. The SRA emphasises the need to demonstrate compliance and keeping a paper trail in this way will be necessary in case a COLP is subsequently challenged regarding his/her effective discharge of the role. These aspects should, we would suggest, be considered and embodied in a members/partnership agreement, or, if the Management arrangements are separately recorded, that document should be suitably amended to reflect the position.

In the light of the discussion above regarding the ability of a COLP to act independently in the manner we have described, those who are designated as COLP will need to ensure they are in a position to be able to discharge the role and will need to consider the extent to which they are in a position to take all reasonable steps to ensure compliance by the firm, its employees and managers:

- with the terms of the firm's authorisation;
- with the SRA's regulatory arrangements; and
- with relevant statutory obligations.

As soon as reasonably practicable, the COLP will need to report to the SRA any failure to comply where such failure is material either on its own or as part of a pattern. That responsibility is independent of the firm itself taking steps to immediately remedy breaches. Whether a failure is material and therefore reportable immediately will need to take account of various factors such as:

- a. the detriment, or risk of detriment, to clients;
- b. the extent of any risk or loss of confidence in the firm or in the provision of legal services;
- c. the scale of the issue;

d. the overall impact on the firm, its clients and third parties.

In addition the COLP will need to keep appropriate records of failures in compliance in order to:

- monitor overall compliance with obligations;
- assess the effectiveness of the firm's systems;
- be able to comply with the duty to report breaches that are material because they form a pattern.

It will be clearly seen from the above potentially onerous responsibilities, that the tension between the role of a COLP and Management on the one hand, and between the COLP and/or managers/employees on the other, is likely to become a very real issue within firms and likely to lead to internal disputes.

Where are the conflicts likely to arise?

It seems to us that one potential area for conflict arises where individual partners or groups of partners fail to follow the necessary procedures for compliance required by the COLP and Management. Management will be as concerned as the COLP to ensure compliance but, whatever procedures are put in place (even if a firm has a policy of 'zero tolerance' regarding compliance), they will in practice still require the co-operation of the members/partners and staff to be effective.

Concerns regarding bad behaviour and poor conduct have been 'accepted' rather than confronted

Experience shows that there is often a reluctance on the part of some to 'be managed' as they perceive it. 'I own this firm as much as anyone else,' is a comment by partners we have heard in a number of firms and a failure to embrace outcomes-focused regulation (OFR) and necessary procedures for compliance will lead inevitably to conflict between individual members/partners, Management and the COLP. Indeed, it is already happening.

Over the years we have seen many examples of situations in which tensions have arisen between Management and members/partners over the implementation of decisions when Management has sought to achieve a particular goal in the perceived 'interests' of the firm and even engineered circumstances to achieve it, giving rise to disputes between Management and members/partners. The nature of OFR is such that many such situations will now fall foul of the SRA Handbook and cause a firm to be in breach of its regulatory obligations.

For example, we have often seen instances where concerns regarding bad behaviour and poor conduct of individuals or a group of individuals have been 'accepted' rather than confronted by Management, in the interests of financial expediency and/or profitability of the firm. The interests of the 'big billing' partners have been preferred in that context to the requirement to bring partners' conduct into line. The 'heavy hitter' partner or group has often been allowed to escape or avoid censure and sanctions.

How will Management and a COLP deal with such partners, whose 'failure to obey the rules' is now likely to put a firm and everyone in a firm 'at risk' of action by the SRA, with the consequences which can flow from that? Will a COLP really feel able to report a failure to comply to the SRA in the face of opposition from both Management and other members/partners in such circumstances?

We have also seen examples over the years of older partners being exited inappropriately, and younger talented partners being sacrificed to provide for a continued role in the firm for their seniors, in circumstances which have given rise to justified complaints of discrimination. Such conduct as we have come across would now undoubtedly be in breach of the mandatory principle requiring equality of opportunity and respect for diversity, so as to prevent unlawful discrimination taking place. Previously, such issues would have been dealt with as between Management and the complainant and the tribunals. Now they are a matter of SRA regulation and a COLP will not be able to avoid involvement if he or she is to properly and effectively discharge the responsibilities of the role.

Will COLPs feel able to report a failure to comply in the face of opposition from Management?

What will happen in such situations when a COLP tells Management that it must not implement its decision, otherwise the firm will be in breach of its regulatory obligations, which will require the COLP to make an immediate notification to the SRA?

Moreover, it is clear that the COLP will have to play a proactive role in ensuring compliance, by considering not simply whether the firm has appropriate policies and procedures in place but that the policies and procedures are 'lived' on a daily basis throughout the firm by everyone, including by Management.

The scope for conflict between a COLP, Management and individuals is real and significant, and while it is not feasible to provide for all eventualities, if the potential for conflict is not provided for, then it will be difficult, if not impossible, for a COLP to effectively fulfil the role. The COLP, the firm and its members and partners will all then be at risk.

Review governance arrangements

We suggest that, for the proper execution of the responsibilities of a COLP (and of the COFA for that matter), the duties of members and/or partners as are currently set out in their membership agreement/partnership agreement should be revisited, amended and supplemented by incorporating appropriate provisions relating to compliance, including:

- Members/partners are obliged to comply with all the principles, outcomes, rules and other requirements of the SRA Handbook and of all other regulation affecting the firm.
- Members/partners lend themselves to such procedures as are necessary on the part of Management and/or the COLP to ensure that the firm is at all times compliant and that they expediently and fully render all such assistance to Management and/or the COLP as may be necessary. Breach of

the above obligations could carry sanctions such as suspension, an involuntary retirement notice or expulsion.

- Consideration should be given to incorporating a whistleblowing policy, such as is referred to in indicative behaviour 10.10 in the SRA Code of Conduct.
- The COLP should have such full access as is required to all limited liability partnership (LLP)/partnership information and documentation, including (if not part of Management) the right to attend Management meetings.
- Recognising that there may be differences of opinion between Management and/or managers/employees and a COLP, as to aspects of compliance, the COLP should be indemnified by the firm/LLP in relation to the execution of his/her duties, particularly to the extent that he/she becomes involved in penalties, costs or expenses.
- It should be provided that the COLP is entitled to take independent external advice at the firm's/LLP's cost where a compliance issue arises and that the firm/LLP and its members/partners agree to accept and implement such advice.
- Consideration should be given to a provision for the resolution of disputes as between the COLP and Management and/or managers/employees.
- It would also be appropriate to consider whether the COLP (and any 'deputy' the firm may wish to put in place to ensure continuity) should undertake at the expense of the firm such training as may be required.
- Consideration should be given to the documentation incorporating provision for the appointment and/or resignation of the COLP and in appropriate circumstances the training and appointment of a deputy COLP.

The focus of the responsibilities of a COLP will be strict compliance with all regulations affecting a firm (including those under the SRA Handbook) and, while the obligation of Management is the same, Management's perspective is often likely to be different and so it is inevitable that conflicts will arise. Management has a business to run, with responsibility to act in the interests of the business, and is likely to focus on the effect of the issue on the firm and the steps required to be taken to deal with that issue in the interests of everyone in the firm.

Reconciling such conflicts will be a difficult challenge for law firms if the role of the COLP is to be workable and appropriate candidates are to be attracted to and retained in the role. Only time will tell whether, as the SRA uses COLPs to 'police' their firms, the role of the COLP will in practice be workable. This outcome is likely to depend as much on the proportionality of the approach taken by the SRA towards COLPs, as the manner in which COLPs fulfil their responsibilities.

Peter Scott runs his own professional consulting practice and is also a consultant with Penningtons LLP. Stephen Ralph is a consultant at Penningtons LLP.