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Dear Des,

Regulatory Independence

This letter and the enclosures detail the final documents we will need and procedures we will follow in order to complete this year's Internal Governance Rules (IGRs) process. It responds to the papers that have formed the basis of Council's decision today, Des' letter of yesterday's date, the draft material we have seen setting out how the proposed arrangements address concerns previously raised by the SRA and the various other exchanges since our letter of 14 October.

We welcome and support the substantial efforts made by the Law Society and SRA to deliver lasting compliance with our IGRs made under s30 Legal Services Act (LSA) 2007. It is clear that significant progress has been made, both in relation to formal structures and the quality of the underlying relationship between the arms of the Law Society. Subject to what is set out in this letter and its annex, we expect to be able to recommend to the Board at its meeting on 30 November that it should, in early December, be able to declare that the arrangements are compliant, provided that the full formal delegations to both the Business and Oversight Board and the SRA are agreed by Council on 9 December.

It follows that we consider that the arrangements that are being finalised are potentially able to deliver independent regulation. But I am sure that you will agree that it is how the agreement operates in practice which will secure lasting independence and compliance. The more complex any particular arrangements are, the greater is the risk. We therefore intend to work with you to set up effective monitoring on the basis described below. We would be happy to discuss the detail of this further.

Noting the complexity of the arrangements, the Board is likely to consider that some substantive monitoring of the arrangements will be necessary by all parties to ensure both momentum in delivery and ongoing compliance. Our expectation is that this can be reviewed relatively soon after the arrangements are fully implemented, perhaps six months or so into the tenure of the new Director of Organisation and Services.

We consider that there should be two key elements to monitoring, which we would request under s55 of the LSA 2007:

- First, a short report, which we suggest should be monthly for the first six months, on delivery against the timetable for implementation. Any major problems between reports would be reported swiftly. This report should be submitted by the CEO of Law Society, with the opportunity for CEO of SRA and the Director of Organisation and Services to comment.
- Second, we would like to receive copies of the Business and Oversight Board agenda and papers at the same time as they are submitted to Board members. This should give us a better understanding of how the revised arrangements are operating in practice and so remove the need for more detailed information requests.

It would also be useful to schedule regular meetings of the three of us and the MD Shared Services to review this information and “trouble shoot” any problems and, of course, the LSB’s door remains open for any bilateral discussions of specific issues if they cannot be resolved without our intervention.

It is important that all aspects of the final arrangements are brought together so that a common understanding is in place that will provide us and the public with confidence that compliance is being secured and that the Law Society is discharging its oversight role effectively and proportionately. We therefore set out in the attached appendix our relatively few remaining concerns and questions regarding the current proposals and would expect to see these addressed in the following suite of documents:

- An explanation, with which both the SRA and Law Society are content, of why each of the issues raised by the SRA’s draft certificate responses in May would not occur under the proposed arrangements.
- A response to our letter of 14 October, including the final agreement between Law Society and SRA, all relevant documents for the new arrangements, supporting papers, Board and Council papers and any side letters of agreement.
- An agreed response to the points raised in the appendix to this letter.
- A timetable, including milestones and responsibilities, for implementing the new arrangements. For avoidance of doubt this should include the route to the formal

designations to the new Business and Oversight Board and SRA; and to the delivery of a lay majority on the SRA Board.

- Finally, each party should sign the abridged regulatory independence certificate enclosed with this letter. This will allow me to assure my Board that we can be confident that you will deliver compliance with our internal governance rules in practice.

As is our usual practice, we envisage that all the above documents will be published alongside our Board's final assessment. We would hope that a Council decision on delegations on 9 December would enable this to be done on the following day.

I am writing in similar terms to Antony.

Yours sincerely,



Chris Kenny
Chief Executive
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Appendix A

The Law Society and the SRA's proposals on governance

November 2011

Lay Majority of SRA Board

For obvious reasons the agreement is silent on the issue of lay majority of the SRA Board. However we would be grateful if the Law Society / SRA could confirm that they remain on track to meet the previously agreed timeline detailed in our letter of 11 November 2010, to achieve a lay majority of the regulatory board and the required change in arrangements so as to allow a lay chair of the SRA, as required by Part 1 (C) of the schedule to Internal Governance Rules 2007 (the IGRs).

Delegations

How will the Council, and the Business and Oversight Board (BOB) serving in an advisory role, ensure that the process of budget approval will be transparent, fair and with appropriate checks and balances between the Law Society and SRA as required by Part 3 (C) of the IGRs and our accompanying guidance?

Oversight Protocol

You intend to delegate the provision of shared services directly to BOB and its staff. We consider that it would give similar clarity were the oversight of the SRA Board be formally undertaken by BOB and staff reporting to it on behalf of Council, rather than, as seems to be proposed, the staff undertaking oversight also to have representative responsibilities. This leads us to consider that there could be a significant risk to compliance in practice. We note that steps are being taken to structure the professional arm of the Law Society so as to avoid this risk materialising and similarly we note the role of the BOB providing independent oversight of that oversight of the SRA. However, we would be grateful if the final documentation could address the scope for "cleaner" reporting lines for staff involved in oversight.

So that we can confirm that our proposed monitoring arrangements are adequate, can you please confirm that there are no areas where the SRA Board or executive will need to seek a before the event authority from the representation arm of the Law Society as opposed to the shared services function?

In addition, paragraph 4 of the oversight protocol and paragraph 3 of the template council report allude to the ability, in exceptional circumstances, of the Council to intervene to change or to redesign the regulatory arrangements of the SRA. We would like some clarification on what the intention is behind this statement and how they would comply with our rules¹?

¹ The IGRs do allow Applicable Approved Regulators (AAR) to dismiss regulatory board members, but only with the concurrence of the LSB (unless they were likely to be exposed to any material legal liability as a consequence of any delay from seeking the LSB's concurrence - Part 2 (D)). In addition Part 4 (B) makes it clear that AAR cannot make directions in respect of the management or performance of regulatory functions unless with the concurrence of the LSB.

Shared Services

The overall responsibilities of BOB and the new Director of Organisation and Services seek to resolve the perceived problems regarding the delivery of appropriately differentiated shared services to the SRA. Looking at the agreement, we envisage a process where the SRA determines the precise services they require and commission these services from the Director according to a transparent policy determined by BOB. We therefore assume that it is for BOB to ensure that all shared services processes are compliant with Part 3 (D) and the accompanying guidance. This includes the provision of transparent and fair dispute mechanisms, ensuring that SRA have the freedom to use an alternative provider where they believe effectiveness and / or independence is compromised, ensuring that there is no un-agreed discrimination in quality or volume of services between the representative and regulatory arms and that clear service level agreements are in place. Can you confirm that this will be the case?

Appointments - Paragraph 4

Our rules and guidance² require strong involvement from the regulatory boards in regulatory board appointments. The agreement only allows regulatory board members to 'advise' on appointments to the regulatory board. How does this constitute strong involvement at all stages?

We have also noted the points in the 8 November letter about whether BOB should have a lay majority. We will consult our Board further on this issue. However, in advance of that discussion, it would be helpful to have an assurance from both parties that the key criteria for appointment of both their own representatives and the non-executives members will be the ability to effectively manage the oversight arrangements and ensure value and effectiveness in shared services, rather than there being any formal or informal "quota" of professional members.

Remuneration - Paragraph 23 and 24

The new arrangements seem to leave two significant loose ends. We note that BOB has the authority to agree delegation to individual Chief Executives in relation to pay matters. Does this arrangement meet the requirements of the rules and the spirit of the guidance³, which, as you know, starts from the assumption of maximum autonomy and the minimum of corporate "rules" (for example in relation to pension strategy).

We also note that there remains some representative input into individual remuneration through membership of the Remuneration Committee. How will you monitor this area to ensure that these processes operate independently in practice?

² Part 2 (1) of the IGRs on appointments stipulates that appointment process must be demonstrably free of undue influence from persons with representative functions. Our guidance suggests that if the regulatory board does not lead on managing the appointments process, it should have a very strong involvement at all stages. The letter sent on 2 December 2008, and referred to in the schedule, also suggested that approved regulators should consider to what extent the regulatory board should be charged with the practical management of the mechanics of the appointment process (especially for ordinary members).

³ Part 2 (C) of the IGRs requires that decisions in respect of remuneration of regulatory board members must 'respect' the principles of independence. Our guidance further adds that such decisions should not be controlled wholly or mainly by persons responsible for representative functions.