

# Investigation Report

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**Investigation into the Law Society's oversight and monitoring arrangements for the Solicitors Regulation Authority**

**May 2018**

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## Executive summary

### Who we are

1. The Legal Services Board (LSB) is responsible for overseeing the legal services approved regulators (ARs) in England and Wales. We are independent of government and of the legal profession. We hold the ARs to account for the different branches of the legal profession. We drive change in pursuit of a modern and effective legal services market: one that better meets the needs of consumers, citizens and practitioners.

### Regulatory independence

2. The Legal Services Act 2007 (the Act) does not create a framework in which all regulatory bodies are structurally separate from representative bodies. Rather, it creates ARs which may have both representative and regulatory functions.<sup>1</sup> Our responsibilities include a duty to make Internal Governance Rules (IGR) (Annex A), setting out requirements that ARs must meet to ensure the independent exercise of regulatory functions.<sup>2</sup> Putting in place IGR to advance regulatory independence was one of the LSB's first priorities on being established. The importance of independence in legal services regulation is undiminished.
3. The main body of the IGR sets out general requirements that apply to all ARs. The Schedule to the IGR prescribes more detailed requirements that apply only to 'applicable approved regulators' (AARs) such as The Law Society (TLS).<sup>3</sup> The Schedule addresses issues of governance, appointments to the regulatory board, regulatory strategy and the provision of resources, and oversight. The requirements in the Schedule are arranged into principles, rules and guidance.
4. One of the Principles of the Schedule to the IGR (Principle 4) is that the '[O]versight and monitoring by the AAR (which is ultimately responsible and accountable for the discharge of its regulatory functions) of persons performing its regulatory functions must not impair the independence or effectiveness of the performance of those functions'. The investigation focused on this requirement.

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<sup>1</sup> On commencement of Part 1 of Schedule 4 to the Act, or as a consequence of designation by order of the Lord Chancellor, following a recommendation by the LSB.

<sup>2</sup> Section 30 of the Act.

<sup>3</sup> AARs are ARs that satisfy both of the following conditions: they are responsible for the discharge of both regulatory and representative functions in relation to legal activities and they regulate persons whose primary reason to be regulated by that AR is those persons' qualifications to practise a reserved legal activity that is regulated by that AR.

## Why we investigated

5. In August 2016 we asked the Solicitors Regulation Authority (SRA) and TLS to advise us whether there were any matters which they considered rendered them unable to comply with the IGR, under Rule 9(b) of those rules.<sup>4</sup> Over the previous months, we had become aware, through discussions with both parties, that there may have been complications with the oversight and monitoring arrangements. On 15 February 2017, following consideration of the information that we received from the SRA and TLS, the LSB decided to commence an investigation into the oversight and monitoring arrangements between TLS and the SRA.

## Scope of the investigation

6. The scope of the investigation was to assess whether TLS's oversight and monitoring of the SRA was such that representative functions impaired the independence or effectiveness of the performance of the SRA's regulatory functions, in breach of Rule 8 of the IGR. Rule 8 obliges AARs, such as TLS, to have in place arrangements that meet the requirements of the Schedule to the IGR.
7. In particular we looked at the four main TLS bodies that exercised oversight and monitoring responsibilities. We looked at the intended role and subsequent operation of:
  - the Business and Oversight Board (BOB) (the Board TLS chose to establish to exercise its core oversight and monitoring responsibilities of the SRA)
  - TLS's Council, the Remuneration Committee (RemCo) and the Audit Committee (AC), but only to the extent they exercised TLS's oversight and monitoring of the SRA's performance of regulatory functions, during the relevant period.
8. The relevant period for the investigation ran from autumn 2014, when TLS and the SRA indicated to the LSB there was an intention to review the role of the BOB and the SRA expressed concern that this was being undertaken to increase TLS control of the SRA, up to 15 February 2017.
9. As indicated in our letter to TLS dated 20 March 2017, we kept the scope of the investigation under review during the course of our investigation. On the basis of the evidence we had gathered we considered whether we needed to extend the scope of the investigation to consider a breach of Rule 6 of the IGR (Rule 6 sets out that each AR must have arrangements that observe and respect the principle of regulatory independence, and must act in a way which is compatible with the principle, and which it considers the most appropriate for meeting the purpose of

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<sup>4</sup> Rule 9(b) of the IGR states: "Each AAR, jointly with its regulatory board, must: ... (b) if it considers itself not to be compliant with these Rules, in some or all respects, notify such non-compliance...".

that principle.) Based on our analysis of what we found, we did not consider it a reasonable course of action to reopen the scope of the investigation to determine whether there had also been a breach of Rule 6.

### **How we carried out the investigation**

10. To undertake the investigation we gathered and reviewed documentation, we met the external members of the BOB (who were also the external members of the RemCo) and the external chairs of the AC, and then we met with senior staff at the SRA. Details of the specific documentation reviewed and who we met with can be found at Annex C.

### **Compliance with Rule 8 and the Schedule to the IGR**

11. The relevant Rule of the IGR that we considered as part of the investigation was Rule 8. With regard to the Schedule to the IGR, our focus was on Principles 2(1) and 4 (in particular rule 2B of Part 2 covering appointments and reappointments to the SRA's Board and rule 4A of Part 4 covering oversight and monitoring arrangements, see Annex A for further detail).

12. In reviewing the evidence (see Sections 5, 6.1 and 6.2) we gathered against the Schedule, we identified the following:

- The SRA, as the regulatory body, was not responsible for designing the competency requirements and designing and managing the appointments and reappointments process for its own Board members. This is in breach of rule 2B and therefore a breach of Principle 2(1) of the Schedule to the IGR.
- The oversight and monitoring arrangements were not proportionate or transparent as there was: (a) an overlap and ambiguity in the terms of reference for the oversight bodies resulting in duplicative reporting requirements and a lack of clarity as to who was accountable for scrutiny of each aspect of the oversight of the SRA and the related decisions; and (b) TLS's General Regulations were incomplete and out of date; and (c) there was a lack of a shared understanding as to what each body in the oversight arrangements should do, see and discuss and how they linked with each other. This in breach of rule 4A of the Schedule.
- The outcome of the oversight and monitoring arrangements was that the combination of multiple reporting demands and associated delay had a direct impact on the SRA's efficiency, and so impaired the SRA's effectiveness in performing its regulatory functions to some degree. This is therefore a breach of Principle 4 of the Schedule to the IGR in respect of the effectiveness of the SRA's performance of regulatory functions.
- The oversight and monitoring arrangements did not impair the SRA's independence.

13. Whilst we did not find that the SRA's independent performance of its regulatory functions was impaired, TLS's General Regulations provided the potential for the SRA's independence to be impaired if the risks related to certain provisions were to crystallise. There is scope to limit these opportunities.

### **Conclusion**

14. In summary we consider that Rule 8 of the IGR was breached because the SRA's effectiveness was impaired by TLS's oversight and monitoring arrangements.

15. Learning from this investigation has been fed into the 2017/18 LSB's review of the IGR.

# 1. Background

## 1.1 Who we are and what we do

2. The Legal Services Board (LSB) is responsible for overseeing the legal services approved regulators (ARs) in England and Wales. We are independent of government and of the legal profession. We hold the ARs to account for the supervision of the different branches of the legal profession. We drive change in pursuit of a modern and effective legal services market: one that better meets the needs of consumers, citizens and practitioners.

## 1.2 Regulatory independence

### The Internal Governance Rules

3. The Legal Services Act 2007 (the Act) does not create a framework in which all regulatory bodies are structurally separate from representative bodies. Rather it creates ARs which may have both representative and regulatory functions. It is the responsibility of the ARs to separate its regulatory and representative functions. However, once the ARs have established separate regulatory and representative functions it is clear from the Act that they retain a residual statutory role.
4. Section 30 of the Act provides that the LSB must make internal governance rules to be met by the ARs for the purposes of ensuring (amongst other things):
  - that the exercise of their regulatory functions is not prejudiced by any representative functions they may also have
  - that the ARs ensure that the regulatory functions are provided with the resources reasonably required to exercise regulatory functions
  - that decisions relating to the exercise of regulatory functions are so far as reasonably practicable taken independently from decisions relating to the exercise of any representative functions.<sup>5</sup>
5. We introduced the IGR in 2010 and they take a principles-based approach for all ARs. The IGR reflect that the Act does not impose a particular model on the ARs regarding the performance of regulatory functions. The ARs enjoy some discretion in arranging the structure of their representative and regulatory arms in a way that fits their circumstances and in a manner they determine to be reasonably practicable. The rules, therefore, allow the ARs to act in the way that they consider most appropriate for the purpose of meeting the 'principle of

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<sup>5</sup> 'Regulatory functions' and 'representative functions' are defined in section 27 of the Act.

regulatory independence' (which is narrowly defined in the IGR at Rule 6 (Annex A)).

6. Whilst the main body of the IGR sets out general requirements that apply to all ARs, the Schedule prescribes more detailed requirements that apply only to 'applicable approved regulators' (AARs). AARs are ARs that satisfy both of the following conditions:
  - they are responsible for the discharge of both regulatory and representative functions in relation to legal activities
  - they regulate persons whose primary reason to be regulated by that AR is those persons' qualifications to practise a reserved legal activity that is regulated by that AR.

The Schedule addresses issues of governance, appointments to the regulatory board, regulatory strategy and the provision of resources, and oversight by the AAR of the regulatory board. The requirements in the Schedule are organised into principles, rules and guidance.

7. Under the IGR (Rule 9(b)), there is also an obligation on the AAR, acting jointly with its regulatory board, to notify the LSB if it considers itself not to be in compliance with the IGR. This does not have to be done in the context of a request from the LSB; it is a stand-alone obligation.
8. We have carried out this investigation using the IGR dated April 2014 (see Annex A) as these were the rules that were in place during the period under investigation. However, the LSB is currently undertaking work to review the IGR. The IGR have not been reviewed in full since they were first introduced more than seven years ago. During this time, there has been (amongst other things) evidence of ongoing and significant disagreements about independence between ARs and regulatory bodies – such as the matter under investigation – and the possible duplication of oversight of regulation between ARs and the LSB. Learning from this investigation will inform our review of the IGR.

#### Application of the IGR – The Law Society and Solicitors Regulation Authority

9. The Law Society (TLS) is an AR under the Act. As a professional body its functions include both representing and regulating solicitors. It is also entitled to undertake non-regulatory 'permitted purposes', such as participation in law reform and the education and training of authorised persons.<sup>6</sup> TLS is also an AAR under the IGR, it is the AAR for solicitors and their businesses.
10. It is the responsibility of the AR, in this case TLS, to comply with the IGR and its Schedule. To comply with the requirements of the IGR to separate its

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<sup>6</sup> Defined in section 51 of the Act.



representative and regulatory functions, TLS chose to delegate its regulatory functions to the Solicitors Regulation Authority (SRA). TLS also established processes to meet the requirements of the IGR Schedule including developing its oversight and monitoring arrangements for the SRA.

11. From 2010 to 2013 we required TLS and SRA to self-certify that they complied with the requirements of the IGR and its Schedule. Through this process we determined that we were broadly content with the processes that had been agreed by TLS and the SRA including those for overseeing and monitoring the performance of the SRA (Annex B).
12. In having regard to best regulatory practice, ARs should review their compliance with the IGR from time to time, including the oversight and monitoring arrangements they have established to assess the extent to which they remain fit for purpose. Since January 2017, TLS and the SRA have engaged in a review of the oversight and monitoring arrangements to identify changes that they wished to make. Neither the substance nor the impact of any such changes agreed between TLS and the SRA have formed part of this investigation.

## 2. The investigation

### 2.1 Decision to investigate

13. In August 2016, under Rule 9(b) of the IGR, we asked the SRA and TLS to advise us whether there were any matters which they considered rendered them unable to comply with the IGR.<sup>7</sup> Over the previous months, concerns had been expressed to us about the operation of the oversight and monitoring arrangements.

14. Representations were made to us by the SRA in September 2016 and information was also provided by both the SRA and TLS in November 2016 and January 2017. Following consideration of this information, we decided on 15 February 2017 to commence an investigation into the oversight and monitoring arrangements between TLS and the SRA.

### 2.2 Scope of the investigation

15. The scope of the investigation was to examine whether TLS's oversight and monitoring of the SRA were such that TLS's representative functions impaired the independence or effectiveness of the performance of the SRA's regulatory functions, in breach of Rule 8 of the IGR. Rule 8 of the IGR obliges AARs, such as TLS, to have in place arrangements that meet the requirements of the Schedule to the IGR.

16. In particular we looked at the four main TLS bodies that exercised oversight and monitoring responsibilities. We looked at the intended role and subsequent operation of:

- TLS's Business and Oversight Board (BOB)
- TLS's Council, the Remuneration Committee (RemCo) and the Audit Committee (AC), to the extent that they exercised TLS's oversight and monitoring of the SRA's performance of regulatory functions during the relevant period.

17. The relevant period for the investigation ran from autumn 2014 to 15 February 2017. The period under investigation ran from when TLS and the SRA indicated to the LSB there was an intention to review the role of the BOB (and the SRA expressed concern that this was being undertaken to increase TLS's control of the SRA) to the date of our decision to launch the investigation.

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<sup>7</sup> Rule 9(b) of the IGR states: "Each AAR, jointly with its regulatory board, must: ... (b) if it considers itself not to be compliant with these Rules, in some or all respects, notify such non-compliance...".

18. We kept the scope under review during the course of the investigation and were mindful of the potential for it to be amended in light of new evidence (see Section 3, paragraph 21).<sup>8</sup>
19. The investigation focused on the oversight and monitoring structures in place and how they operated during the relevant period. Whilst the operation of those structures depended, in part, on the cultures prevailing in both organisations, we have not sought to assign responsibility to specific individuals at the SRA or TLS.

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<sup>8</sup> When we informed TLS of the scope of the investigation on 20 March 2017 we stated that it was open to us to rescope the investigation if new evidence came to light during the course of the investigation ([http://www.legalservicesboard.org.uk/what\\_we\\_do/pdf/20170320\\_NB\\_To\\_PT\\_Letter\\_re\\_Scope\\_Of\\_Investigation.pdf](http://www.legalservicesboard.org.uk/what_we_do/pdf/20170320_NB_To_PT_Letter_re_Scope_Of_Investigation.pdf))

## 3. How we carried out the investigation

### 3.1 Approach to the investigation

20. To undertake the investigation we gathered and reviewed documentation, met the external members of the BOB (the external members of the Business and Oversight Board also sit as the three external members of the Remuneration Committee), the external chairs of the Audit Committee, and we met senior staff at the SRA. Details of the specific documentation reviewed and those we met can be found at Annex C. We then assessed the evidence we had gathered against the Schedule to the IGR (April 2014, Annex A).
21. As indicated in our letter dated 20 March 2017 to TLS, we kept the scope under review during the course of our investigation. On the basis of the evidence we had gathered we considered whether we needed to extend the scope of the investigation to consider a breach of Rule 6 of the IGR. Rule 6 of the IGR imposes a general overarching duty on each approved regulator to have in place arrangements which observe and respect the 'principle of regulatory independence'.<sup>9</sup> This is a separate requirement to those additional, more detailed and onerous requirements set down in Rule 8 through the Schedule to the IGR and imposed on AARs. Based on our analysis of what we found, we did not consider it a reasonable course of action to reopen the scope of the investigation to determine whether there had also been a breach of Rule 6.
22. A draft of the report was shared for a factual accuracy check on 14 March 2018 with TLS, the SRA and the external members we met. One of the external members sadly died before they were able to comment on the draft report but we are confident that we have fairly represented their previously agreed evidence. The LSB carefully considered the comments we received and, where they indicated that there were factual inaccuracies in the report, we made amendments.

### 3.2 Layout of the report

23. The report is structured as follows:

- the oversight and monitoring arrangements in place
- evidence regarding the operation of the oversight and monitoring arrangements

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<sup>9</sup> This is specifically defined in Rule 1 of the IGR as 'structures or persons with representative functions must not exert, or be permitted to exert, undue influence or control over the performance of regulatory functions, or any person(s) discharging those functions'. 'Undue influence' is defined in Rule 2 of the IGR as 'pressure exercised otherwise than in due proportion to the surrounding circumstances, including the relative strength and position of the parties involved, which has or is likely to have a material effect on the discharge of a regulatory function or functions'.

- the LSB's view as to the combined impact of those arrangements on the SRA's independence and effectiveness
- compliance with Rule 8 and the Schedule to the IGR.

24. We would like to thank everyone who participated in this investigation for their time and contributions.

## 4. The oversight and monitoring arrangements

25. The diagram overleaf [on page 16] presents our summary of the oversight and monitoring arrangements in place during the relevant period, as described by the July 2015 version of TLS's General Regulations. TLS has a group structure and its financial reporting is therefore on a consolidated basis. Its governance arrangements necessarily oversee the entities consolidated within the group, not just those of the SRA.

26. We discuss in Section 5 the operation of TLS's four oversight bodies, in scope of the investigation, during the relevant period. These are:

- TLS's Council is TLS's governing body. During the relevant period it received reports from TLS's other oversight bodies on the performance of the SRA, as well as an annual report from the SRA on its own performance.
- The Business and Oversight Board (BOB) is the body through which TLS has chosen to exercise its AR responsibility. During the relevant period it had a dual role of overseeing the performance of the SRA and of Corporate Solutions/Shared Services (the shared back office services).
- The Audit Committee (AC), during the relevant period, this Committee had responsibility for keeping under review the arrangements for internal audit, internal control, risk management and corporate governance and advised generally on all aspects of audit and financial control within TLS.
- The Remuneration Committee (RemCo), during the relevant period, made recommendations to the Management Board (for TLS) and the SRA Board (for SRA) on the pay policy, terms and conditions, incentives, severance payments and performance management frameworks in place for the two Chief Executives of TLS and SRA and their Senior Management Teams. (It carried out a similar role for the Chief Operating Officer of Corporate Solutions and the Senior Management Team reporting to him.) It also made recommendations to the BOB on remuneration and terms and conditions of the SRA Board and Chair.

**Annex D** details the terms of reference and membership of the BOB, the AC and the RemCo.

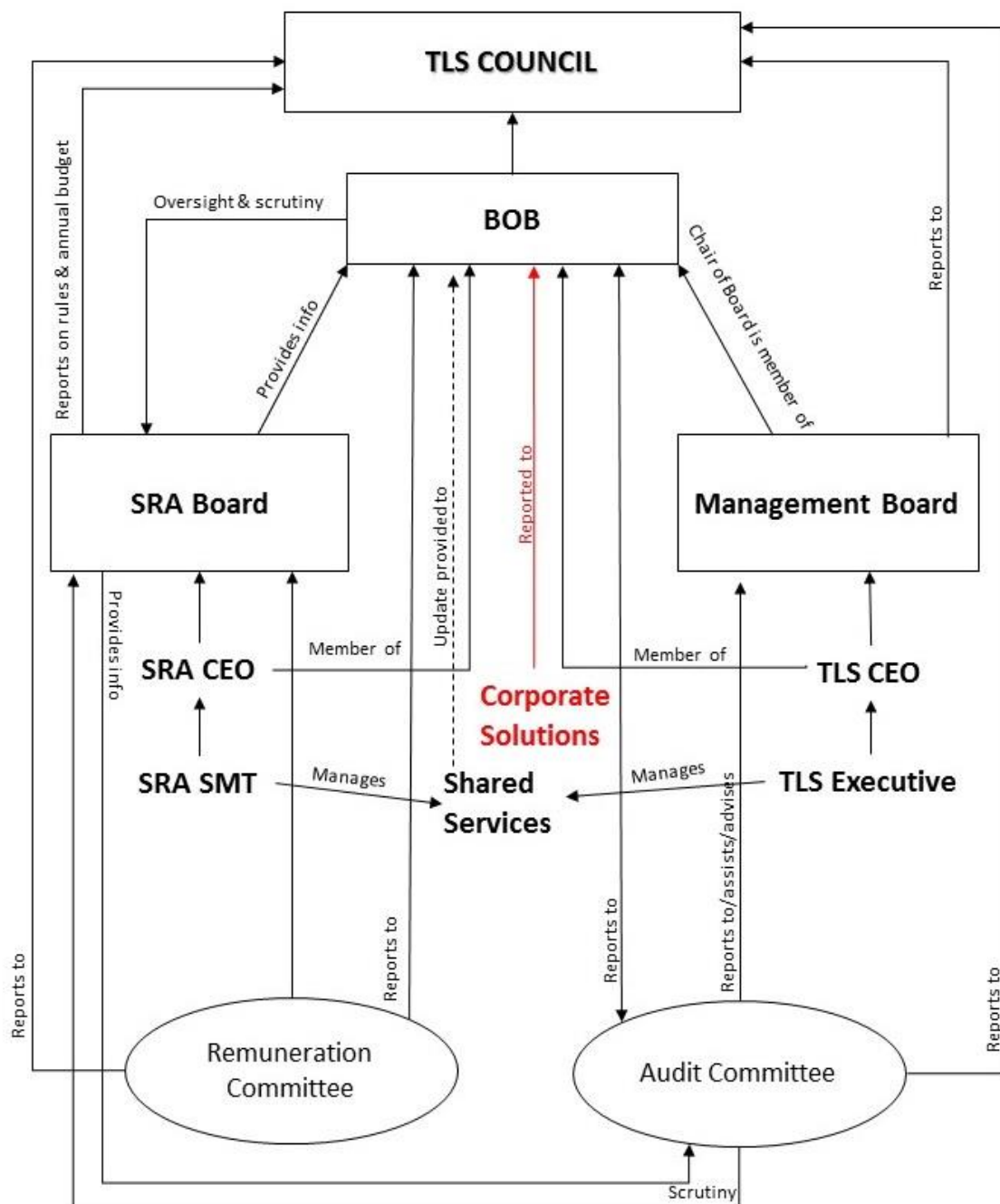
27. Other Boards and Committees referred to in our investigation are:

- TLS's Management Board (MB), which during the relevant period advised TLS's Council on the exercise of TLS's functions as AR, except for matters delegated to the BOB and the SRA Board. The MB recommended TLS's budget and business plan to TLS's Council, oversaw the work of TLS's Chief Executive and their team and approved the annual report and financial

statements for adoption at TLS's Annual General Meeting. The MB also recommended to TLS's Council the amount to be collected through practising certificate fees and contributions to the compensation fund.

- The SRA Board determined the overall regulatory strategy of the SRA, and oversaw the work of the SRA's Chief Executive and his team. The relevant Committees for the purpose of this investigation are:
  - The SRA's Finance and Audit Committee (FAC) (and the previous Finance and Resources Committee) which, during the relevant period, provided advice and assurance to the SRA Board on all matters relating to the efficient and effective management of financial resources and audit functions across the organisation. The Finance and Audit Committee was established in early 2016.
  - The SRA's People Strategy Committee which, during the relevant period, had oversight of the SRA's human resources and people strategy. It also advised the SRA Chair on appointments (including the establishment and oversight of the appointments panel), remuneration, performance and appraisal processes and contractual matters relating to the SRA Board Members, Committee Members, external advisory members and the Senior Management Team. The People Strategy Committee was established in early 2016.

Figure 1: Governance relationships during the investigation period





## 5. The oversight and monitoring arrangements in practice

28. In this Section we consider the operation of the four TLS bodies with oversight responsibility for the SRA, in scope of the investigation (TLS's Council, the BOB, the AC and the RemCo). For each body we set out its role in the oversight of the SRA, the SRA's concerns, and the evidence we found of the oversight undertaken. We then go on to discuss the interactions between each of the bodies and the administrative arrangements relating to them.

29. We have set out at Annex E a timeline of the meetings and oversight activity that took place during the relevant period. Unless otherwise stated, any reference to TLS's General Regulations are to the July 2015 version.

### 5.1 TLS's Council's oversight of the SRA

30. TLS's **Council** is TLS's governing body with responsibilities derived from statute, its Royal Charter, bye-laws and General Regulations. TLS's Council is composed of solicitors and one trainee solicitor. TLS's Council has 100 members, with 61 members representing 42 geographical constituencies and up to 39 members representing special interest groups and areas of practice. It meets up to seven times a year. TLS's Council agrees the strategic direction of TLS's work, decides its position on policy issues, sets the budget and approves the total amount to be collected from regulatory fees (from individuals and firms). It has delegated most corporate functions to the MB and the BOB.

#### The SRA's concerns

31. The SRA expressed to us concern at the level of involvement that TLS's Council had with the SRA's work and the potential for it to overstep its role and affect the pace of regulatory activity during the relevant period. The SRA also highlighted that TLS's Council's involvement in the appointment and reappointment of the SRA's Chair and Board members and the associated documented arrangements were contrary to the IGR.

#### The evidence gathered

32. The General Regulations set out the role and responsibilities of TLS's Council in overseeing the SRA. These covered:

- scrutiny of the SRA's draft and final budget and net funding requirement and the amount to be raised through practising fees and the compensation fund
- the appointment and reappointment of the SRA's Board Chair and members
- review and scrutiny of the SRA's annual report

- review and scrutiny of the BOB's regular reports to TLS's Council on its work, the annual report of the AC and the annual report of the RemCo
- involvement in any rule changes or new rules proposed by the SRA.

33. It also had the power to:

- require litigation related to the discharge of the SRA's functions to be dealt with by the MB (Regulation 31(23)(c))
- issue a direction requiring a rule proposal to not be implemented (Regulation 32(1)(d))
- remove a member of the SRA Board (Regulation 34(6))
- substitute its own procedure for investigating and determining complaints if it believed that the procedure established by the SRA Board was inadequate (Regulation 34(7)).

34. From the reports and minutes that we reviewed, examples of the type of oversight or decision-making TLS's Council had in relation to the SRA included the following:

- October 2015 – TLS Council noted the planned changes to TLS's and the SRA's back office services (the introduction of Shared Services) and agreed in principle the associated changes to the General Regulations.
- July 2016 – TLS's Council members questioned the governance of the SRA's and TLS's IT transformation programme and raised a number of queries about matters such as cyber-security. TLS's Council went on to approve, in principle, the overall approach to the IT transformation programme.
- July 2016 – TLS's Council approved the delegation of the appointment of a member of the SRA Board to the appointments panel established for that purpose.
- December 2016 – TLS's Council members questioned the SRA's budget forecast and whether the SRA thought it might change. The SRA responded to the questions posed following which TLS's Council approved the budget.

#### *Budgetary control*

35. From our review of the papers, we identified that the SRA went through an annual budgeting exercise and any surplus automatically formed a part of TLS's reserves. The SRA's budget was subject to scrutiny by the BOB who then recommended it to TLS's Council. TLS's Council then had to decide whether to approve the budget. Should any additional resources have been required in year, the SRA would have had to seek the release of those funds by TLS's Council.

36. TLS stated that it acted in alignment with section 30(3) of the Act as this envisaged that the AR retained a degree of resource control, subject to an obligation to provide the regulatory arm with such resources as it reasonably required for or in connection with the exercise of its regulatory functions. In turn, TLS stated that it acted in line with the IGR as these required it to provide transparent and fair budget approval mechanisms and a process that provided appropriate checks and balances between the AR and the regulatory body. It said that this was confirmed by the requirement in the IGR that the regulatory body must have the power to do anything 'within its allocated budget' and should, subject to the oversight permitted under the IGR, have the freedom to define a strategy for performing regulatory functions independently of representative control or undue influence.
37. We saw from the minutes of TLS's Council that it took strong account of the recommendations made by the BOB and it did appear to have confidence in the BOB's scrutiny of the SRA's draft and final budget which took place earlier in the approval process. It appeared that TLS's Council relied on the information provided and approved by the BOB to make its decision.

#### *SRA Board appointments and reappointments*

38. Since April 2014, Rule 2B to the Schedule of the IGR requires that the regulatory body must be responsible for designing the competency requirements and designing and managing the appointments and reappointments process for its own Board. TLS's General Regulations (all versions during the relevant period) did not reflect this rule and so the SRA had to continue to seek approval from TLS's Council to appoint and reappoint its Chair and Board members.
39. We saw from the papers, and the SRA confirmed in correspondence with us, that in practice TLS's Council had agreed since 2014 to delegate responsibility for the appointments to the SRA Board members to an appointments panel on a case-by-case basis. We were told by the SRA that no recommendations from the appointments panel or the Chair had been rejected.

#### *Regulatory rules*

40. TLS's General Regulations set down that the SRA's Board may only make rules if it had specifically consulted TLS's Council on the proposal and any significant changes to it, and TLS's Council had not issued a direction requiring the proposal not to be implemented. The SRA's Board also had to notify TLS's President of the final text of any rule and could only seek approval of the rule by any external body seven days after the President had been notified of the final text (these powers may be delegated to TLS's Chief Executive).
41. The SRA provided us with a copy of the protocol it agreed with TLS on rule changes. The protocol was in line with the General Regulations. It required the

SRA to notify the President at least 12 weeks before a rule change. If as a result of consultation with stakeholders there was a significant alteration to the rule, the President would be informed not less than 21 days before the Board made a final decision. There were exceptions in place on the grounds of urgency. In addition the SRA needed to ensure there had been adequate consultation with stakeholders and that any regulatory burden was the minimum necessary to comply with the regulatory objectives in a way that accorded with the principles of good regulation.

42. We have not been told of, or seen in the papers, instances of the rule-making protocol not being followed or of TLS's Council issuing a direction requiring a rule proposal to be not implemented during the relevant period.

*Complaints about SRA Board members*

43. Rule 2D of the Schedule to the IGR states that decisions in respect of '...discipline of persons appointed to the regulatory boards must respect the principle of regulatory independence' and Rule 2E of the Schedule states that 'Except insofar as an AAR would be, or would reasonably be considered likely to be, exposed to any material legal liability (other than to pay wages, salaries etc) as a consequence of the delay required to obtain the concurrence of the [LSB's] Board, no person appointed to a regulatory board must be dismissed except with the concurrence of the Board'.
44. TLS's General Regulations stated that TLS could substitute its own complaints process for investigating and determining complaints against SRA Board members if it considered that the SRA's procedure was inadequate. TLS told us during the 2010 self-certification process (see paragraph 11) that it would only substitute the complaints procedure in rare circumstances and following consultation with the LSB. Given the low likelihood of this happening in practice and the commitment to consult with us should it occur, we accepted the position that the provision could remain and this was reported in our final assessment letter dated 11 November 2010.
45. The General Regulations also set out that only TLS's Council could remove a member of the SRA Board. TLS told us during the 2010 self-certification process that this would only be carried out with the concurrence of the LSB. On this basis we accepted TLS retaining the power to remove a SRA Board member and in light of the commitment to seek the LSB concurrence, we did not insist on the General Regulations being amended immediately. However, we did ask that they were amended as part of the next review of the Regulations. This was reported in our final assessment letter dated 11 November 2010.
46. TLS did not exercise the powers referred to in paragraphs 43 to 45 during the relevant period.

### *Exercising powers*

47. During the relevant period, TLS did not exercise its powers to require litigation related to the discharge of the SRA's functions to be dealt with by the MB.

### *TLS's Council scrutiny and information requests*

48. From the minutes that we reviewed, we saw several examples of TLS's Council questioning the actions of the SRA or those bodies responsible for its oversight:

- February 2015 – it was minuted that TLS's Council felt that the non-collection of some Alternative Business Structures (ABS) fees was a serious regulatory issue and wanted to investigate it further (see paragraph 210 for a timeline of ABS fees collection issue). It was noted that TLS's Council was pleased to hear that the SRA was reconsidering its position as that position (in its view) had been 'inappropriate'. It was minuted that TLS's 'Council hoped for a more positive outcome' and that TLS's Council's position would be communicated to the SRA.
- March 2015 – a paper was presented by the MB Chair on the renewal of the lease of the Martin Lane office. TLS's Council was told that the renewal of the lease had been approved by the BOB and the MB following a preference expressed by the SRA to stay at that location. TLS's Council members challenged the decision to renew the lease and raised concerns about their lack of involvement in the decision. They were informed that the transactions relating to leases was within the remit of the BOB and MB and the paper was presented to TLS's Council for information only.
- May 2015 – the Chair of the RemCo was challenged about the bonuses paid to the SRA's and TLS's Chief Executives as TLS's Council was concerned to ensure that in determining and agreeing the bonuses due process had been followed.
- February 2016 – the SRA presented its annual report for 2014/15 to TLS's Council. At that meeting, TLS's Council expressed concern about receiving the report in view of the SRA's statements on structural separation from TLS. It was suggested that TLS's Council should reserve its position with respect to the report. The President was asked whether noting the report meant that TLS's Council agreed with it. The President replied that it neither meant "agree with" nor "disagree with".
- July 2016 – a Council member asked TLS's Chief Executive to challenge the SRA's spending on events as they queried whether this was an appropriate use of funds. TLS's Chief Executive noted that it might be difficult to challenge the SRA on spending if the events were in furtherance of its regulatory purposes but she confirmed that the point could be raised with the SRA.

49. During the relevant period, TLS reported that no additional information requests were made of the SRA by TLS's Council. The SRA reported that one additional request was made in November 2015. From our review of TLS's Council minutes and other correspondence, we saw that TLS's Council made the following information requests of the SRA during the investigation period:

- December 2014 – TLS's Council asked for further information on the SRA's rationale for not collecting some of the 2011/12 ABS fees. This request was made through the Chair of the BOB.
- February 2015 – Council members, via the Chair of the BOB, asked for further information from the SRA as to how they could wind down law firms that were not the subject of an intervention.
- May 2015 – Council members, through the Chair of the BOB, asked for information from the SRA on the number of uninsured professionals.
- November 2015 – TLS's Council made a request of the SRA through TLS's Chief Executive in relation to applications to the SRA's compensation fund.
- July 2016 – TLS's Council asked TLS's Chief Executive to ask for further information from the SRA in relation to adverse Solicitors Disciplinary Tribunal decisions and costs awarded against costs claimed.

50. We met the external members of the BOB and the RemCo, and the Chairs of the AC and asked their views on the oversight exercised by TLS's Council. The two Chairs of the AC, during the relevant period, did not raise any concerns about the extent of the oversight exercised by TLS Council. A view was expressed by a member of the BOB/RemCo that TLS's Council were generally sceptical of the SRA and that this affected the questions asked; however, it was added that whilst the questioning was robust it did not overstep the mark. Other members of the BOB/RemCo cited examples where TLS's Council could have been perceived to challenge the operational independence of the SRA such as the discussions around the non-collection of some ABS fees. The BOB and the RemCo external members were clear that they policed the boundaries of their remit well; and therefore stopped any potential for TLS's Council to overstep its remit.

## 5.2 The Business and Oversight Board's oversight of the SRA

51. TLS, as AR, retains a role in overseeing the SRA to ensure that it operates in accordance with the Act and within the scope of its delegation. It chose to exercise this responsibility through the **Business and Oversight Board (BOB)**. The establishment of the BOB and its terms of reference were jointly developed and agreed by TLS and the SRA in 2011. Further information on its establishment can be found in Annex B.

52. The BOB had a dual role during the relevant period as set out in its terms of reference. It oversaw the performance of the SRA and it dealt with all matters relating to the provision of support services (as defined in the General Regulations, see Annex D) from Corporate Solutions, and then subsequently Shared Services, to TLS and the SRA.

### The SRA's concerns

53. The SRA's representations to us stated that:

- the SRA experienced duplication in reporting to the BOB and the AC in relation to its strategic risk register and performance (operational, financial, Shared Services and major projects)
- the BOB had three representatives from TLS's Council and TLS's Chief Executive as members, which the SRA considered enabled a disproportionate level of enquiry, investigation and challenge to the SRA's exercise of its regulatory functions<sup>10</sup>
- the BOB's terms of reference were out of step with its current role and the IGR. The terms of reference were not updated following changes made to the provision and management of shared back office services nor did they reflect the IGR in relation to appointments and reappointments of the SRA Chair and Board members.

### The evidence gathered

#### *Reporting*

54. We saw from our review of its papers that the BOB had a number of standard items on its agenda. These were: the SRA Chair's and the SRA Chief Executive's reports (the latter of which was meant to include the strategic risk register, financial and key performance information); a report from Corporate Solutions on shared services (latterly a joint TLS/SRA report from Shared Services); the draft and final net funding requirement and budget; and reports on key projects or specific workstreams such as the internal controls framework and TLS and SRA IT transformation programme. These standard agenda items fell out of the terms of reference recorded in the General Regulations and agreed to by the SRA at its Board meeting of 19 October 2011.

#### *Operational performance*

55. The BOB's terms of reference set out that the BOB was to exercise TLS's AR oversight of the SRA including the scrutiny of the SRA's business plan and monitoring performance against that plan. This oversight was also set down in

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<sup>10</sup> We note that the BOB had equal representation from the SRA (three Board members and the SRA Chief Executive).

the template for the quarterly report to the BOB which noted in Section one that this included details of progress against the business plan, and in Section two, performance against the suite of key performance indicators. We note that the AC received a similar report but with less consistency in its content (see business updates, paragraphs 88–89).

56. From our review of the papers we saw that the BOB received, at each meeting, a verbal or written report from both the SRA's Chief Executive and the SRA's Chair. The SRA's Chair provided a report on what the SRA Board had considered and the SRA's Chief Executive provided a report on operational performance.
57. The BOB's external members told us that the SRA had asked if it could combine the Chief Executive and Chair reports. (This is supported by the minutes of the April 2016 BOB meeting.) The BOB discussed this request but refused it because it was felt that each report reflected the different responsibilities of the post-holder which could not be captured by a single report. This decision was captured in the minute of the June 2016 BOB meeting.

#### *Financial matters*

58. The BOB's terms of reference set out that the BOB was to recommend to TLS's Council the budget for the SRA and to deal with all matters of budgetary control within the SRA. This oversight was also set down in the template for the quarterly report to the BOB which noted in Section 4 that this included reporting of performance against the SRA's agreed budget and headcount, including information on financial controls. Financial performance and controls information were also reported at the AC.
59. From our review of the papers we saw that financial reporting information was provided to the BOB meetings. We also saw that each year the BOB received a draft net funding requirement and budget paper in June and a final net funding requirement and budget paper in October.
60. Also from our review of the papers we identified that Corporate Solutions had produced a paper in October 2014 on the timescales for the collation of budgets and forecasts which it said was dictated by the need to submit financial information prior to the meeting dates of each governance Committee meeting. This allowed time for Board members to read and digest the content prior to meetings but in some cases also compressed the timeframes for staff to prepare and review budget information and to align business plan activities with the available financial resources. It appeared to Corporate Solutions that the budgeting process was driven by key meeting dates rather than by the goals of established business plans. A further paper was produced in April 2015 by Corporate Solutions (with input from the SRA) that noted the approvals process for funding decisions could be very difficult and complicated if scheduling of the



meetings for the various oversight bodies were not in the sequence required for approvals (as was the case at that time).

### *Risk register*

61. The BOB's terms of reference set out that the BOB was to scrutinise the SRA's strategic risk register. This oversight was also set down in the quarterly report to the BOB, the template of which noted at Section three: this will include an update on the SRA 'Strategic Risk Register'. We saw from the report on the outcome of the Corporate Solutions review (October 2015) that it was also recommended that both TLS and the SRA present a jointly agreed view of group level risks to the BOB. We note that the AC also requested sight of and received the SRA's strategic risk register.
62. From our review of the papers we saw that, after the June 2015 meeting until the end of the investigation period, the BOB only received the SRA's strategic risk register in September 2016 and that it did not receive information on the group risk register after the closure of Corporate Solutions. Two of the external members noted that requests had been made for the risk register to be provided to the BOB.

### *Shared Services and major projects*

63. The BOB's terms of reference set out that the BOB was responsible for dealing with all matters related to the provision of shared support services to TLS and the SRA, and to advise TLS's Council on the budget for such services. The oversight in relation to major projects was set down in the quarterly report to the BOB, the template of which noted in Section five that: the SRA should provide commentary on any of the SRA's specific programmes of work, highlighting any particular issues, risks and deliverables. Similar information on major projects was presented to the AC.
64. From our review of the papers we saw that the BOB received regular reports from Corporate Solutions and then, following its closure, from Shared Services. The BOB also received reports on major programmes of work such as the internal controls framework and TLS and SRA IT transformation programme. There was a lack of shared understanding initially on some projects as to the role of the BOB. For example, it took a request from the external members, before they received papers on the review of Corporate Solutions (as evidenced by the minutes) and there was some discussion as to the role of the BOB in the IT transformation programme as evidenced by the November 2016 BOB meeting minutes.

### *Scrutiny of the SRA by the BOB*

65. According to the Financial Reporting Council's (FRC) UK Corporate Governance Code (B5) (see Annex F), boards and committees should be supplied in a timely

manner with information in a form and of a quality appropriate to enable it to discharge its duties.<sup>11</sup>

66. We saw from our review of the papers that from April 2015 onwards there was a decrease in the amount of information (which fell under its terms of reference) provided by the SRA to the BOB. Initially this related to the review of Corporate Solutions, the need for which, we were told by external members and saw from the papers, was decided upon outside the BOB. We also saw from the minutes that the external members firmly expressed the view that the BOB needed to be clearly and correctly involved in this project and that there needed to be a formal business case (regarding the review of Corporate Solutions) produced and presented which properly recognised the BOB's terms of reference. We also saw in the June 2015 minutes that an external member wanted it to be noted that matters relating to the BOB were being discussed outside of the BOB meetings without the external members.
67. We saw from the papers that from September 2015 the SRA's strategic risk register was not regularly provided and the key performance information was not provided in as much detail. For instance, the key performance information changed from wide-ranging and numerous indicators to only the three key indicators that were publicly reported at the SRA Board's meetings.
68. Generally, the BOB's external members felt that the papers provided by the SRA were of a good quality and that there had been no noticeable change in the quality or willingness of the SRA to provide information. However, one said that they had noticed the information from the SRA had thinned over time and that they had challenged this at meetings. In particular, they said that the SRA's strategic risk register had not been sent on occasion and the range and detail of key performance information had reduced. Another member told us that numerous requests were made for the SRA to produce its risk register for discussion at the BOB meetings. The SRA said that the information it presented to the BOB depended on the BOB Chair. It said that different chairs had taken different approaches. If the SRA was not asked to provide the information, it would not have done so just to follow the expectations set down in the governance arrangements.
69. From 2015 onwards, we also identified from the papers, and were told by the external BOB members, that the SRA's concerns about the oversight and monitoring arrangements were not shared with the BOB (such disputes fell under the BOB's terms of reference (regulation 44(5)(c) of the General Regulations). One external member told us that they had been clear that discussing the future of the BOB away from the BOB itself was unsatisfactory (this related to the abandoned effectiveness review of the BOB in 2015) and this was supported by

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<sup>11</sup> This Code is part of a framework of legislation, regulation and best practice standards which aims to deliver high quality corporate governance.

the minutes of the April 2015 BOB meeting. The BOB's external members also told us that they were not directly involved in discussions about the concerns around the arrangements from 2016 onwards. The minutes of the November 2016 BOB meeting state that the 'independent members noted their desire to be involved and engaged in making decisions about matters that affected TLS and SRA, including the future of the BOB'. They also state that they would have appreciated the opportunity to discuss the correspondence on the IGR which had been shared with the LSB (and led to this investigation). They also noted, and this is supported by the November 2016 BOB meeting minutes, that offers were made for the BOB to act as mediator between TLS and the SRA. They told us, and we have seen from the papers, that these offers were not accepted by either the SRA or TLS (although one external member told us that they considered that the SRA was willing to accept the offer).

70. The UK Corporate Governance Code provides that, in conjunction with the information that is presented to it, a properly functioning governance committee will have high quality discussion that is constructive and challenging (see Annex F). Views were expressed by some BOB external members that the level of debate and discussion was affected by the decline in information provision, as the BOB either did not have enough information to challenge or was presented with a final decision rather than options or recommendations. We were also told that the debate and discussion were affected by the often polarised positions of TLS and the SRA, which meant that a more reflective discussion would have made a 'difficult situation worse'. The SRA also raised concerns about the quality of the discussion. We saw from the papers that the length of the meetings and extent of discussion varied over time.
71. The SRA in its representations made clear that, in its view, TLS's membership of the BOB affected the level of debate and discussion as it enabled a disproportionate level of enquiry, investigation and challenge to the SRA Board's exercise of its responsibility for regulatory functions. The SRA could provide no examples that occurred during the relevant period where this impaired its independence. Whilst the external members of the BOB considered that there were often heated discussions at meetings, they did not believe that there were any concerted efforts by TLS to influence the SRA or themselves. We note that during the relevant period we were informed by both TLS and the SRA that the external members of the BOB favoured the other.
72. From our review of the papers, we identified some occasions where the recorded BOB's discussion had the potential to be seen as involving a disproportionate level of enquiry, investigation and challenge. These were:
  - Between November 2014 and May 2015 – the SRA was asked by the BOB and TLS's Council to review its decision not to collect some ABS fees for

2011/12. This delayed the SRA's work on this matter being completed by 6 months.

- February 2015 – the SRA Board agreed at its meeting on 21 January to proceed with the appointment of a Vice-Chair and a paper was presented to the RemCo on 5 February 2015. The RemCo unanimously supported the proposals for the remuneration of a Vice-Chair and the BOB approved the recommendation from the RemCo on the remuneration of the proposed Vice-Chair. At the BOB meeting, a TLS member said 'TLS was looking into the governance process for the role of the SRA Vice-Chair and, until the process had been clarified, TLS agreed in principle, but reserved judgement on the appointment of a Vice-Chair'. We note that the first independent Chair told us that this was something BOB was clear that TLS needed to do outside of BOB.
- November 2016 – in a discussion about investment schemes and consumer risk it was agreed that it was important for confidence in the profession not to be undermined by concerns relating to a relatively small number of firms, at a time when clients needed to be looking to their trusted advisers for assistance. TLS said it was important messaging was proportionate because, if the public lost confidence in the profession, this would be damaging and not in the public interest. TLS therefore urged the SRA to ensure messaging reflected the small number of firms and individuals involved (whilst not underestimating the serious concern). The SRA noted that it had not sought to involve the press in relation to solicitors' involvement in these schemes, though the schemes would be covered in the next Risk Outlook which would be discussed at the SRA Board, and in due course solicitors' involvement in the schemes might give rise to Solicitor Disciplinary Tribunal determinations.

73. TLS told us that the role of the BOB was as a mechanism for accountability; it did not believe that its functions had been prejudicial to the regulatory functions of the SRA nor had they been unduly onerous. It noted that the fact that the BOB operated at a certain level of inquiry and challenge had not, in its view, prejudiced or impaired the performance of regulatory functions but instead was consistent with the role of an AR balancing its responsibility to ensure separation of regulatory functions with its ultimate responsibility for the discharge of those functions.

74. TLS said that the BOB had not sought or received operational data that risked the independence of the SRA's decision-making in relation to its regulatory functions. Indeed, it noted that the information which had been presented to the BOB was controlled by the SRA and only known to the SRA (with the exception of Shared Services information which had been presented jointly). However, as AR it had been entitled to transparency and the disclosure of factual information around matters like the budget so that it could perform its AR role effectively.

## Effectiveness of the BOB

75. The BOB was a jointly agreed mechanism for TLS to carry out its AR function. However, since 2011 when this mechanism was agreed, there have been changes in the senior leadership and the membership of TLS's Council and the SRA's Board, and the closure of Corporate Solutions.
76. From our review of the papers and minutes, it was clear that the BOB was able effectively to fulfil its role in overseeing Shared Services and recommending the draft and final budget and net funding requirement to TLS's Council. There was clear evidence of challenge by the BOB and of the approval process taking place. However, it was less clear whether it was able to fulfil its role in relation to oversight of performance and risk due to the decrease in information provided (see paragraphs 66-69) and a lack of common view of how this oversight should be carried out.
77. The BOB's external members considered that they had been able to fulfil the BOB's terms of reference but that the BOB had not worked as effectively as it could have done because of the enduring tensions between the SRA and TLS. They told us that the BOB was most effective when it had an independent Chair able to set the right agenda; ensure paperwork was timely, correct and appropriate for discussion; ensure there was an open and transparent debate; and that there was a fair and accurate record of the meeting. In the absence of an independent Chair, they noted that these important factors were neglected. From our review of the papers, we saw that the information from the SRA to BOB began to thin when there was no independent Chair in place.
78. The SRA said that, since the closure of Corporate Solutions, the BOB did not have a 'real function' as there was no longer a separate Corporate Solutions function within the Group with its own head who reported solely to BOB. This had been replaced with a smaller shared service function, jointly managed by senior SRA and TLS executives for whom the lines of accountability ran through the two Chief Executives to the SRA Board and TLS Management Board. While TLS recognised that the BOB's terms of reference did not reflect the current position with regard to Shared Services, it said that the BOB still had a role in overseeing Shared Services and this included the IT transformation programme. It noted that the scrutiny that the BOB applied to the performance of Shared Services remained important. This was particularly true as both parts of the organisation needed to continue to work together while systems remained joined and the ongoing four-year plan for IT transformation was implemented. TLS said that the BOB should remain in place as a mechanism of oversight and accountability for TLS.
79. It is clear from the descriptions provided by TLS, the SRA and the BOB's external members, and from a joint report produced by TLS and the SRA on the role of the AR, that there was disagreement around the role of the AR in overseeing and

monitoring the SRA and therefore the BOB as the mechanism through which this was done. The joint report produced noted that TLS considered that its residual statutory role as AR involved holding the SRA to account for adhering to good governance principles; monitoring its performance in achieving its own strategic aims; and monitoring the efficiency and effectiveness with which the SRA operated and executed its policy decisions. The SRA considered that TLS only needed assurance (across financial, operational and governance performance) that it was acting within the terms of the delegated functions and the Act.

80. The BOB's external members said that the difference in view about the role of the AR (and therefore the purpose of the BOB) had an impact on the BOB. They said that, in order for the BOB to work effectively, it needs a shared purpose, acceptance of the regulatory settlement and willingness and commitment from all parties to make it succeed. The BOB's external members considered that this was lacking during the relevant period. We saw from the papers that this fundamental disagreement also led to a planned effectiveness review of the BOB being delayed and then aborted. This was a possible mechanism through which some concerns had the potential to be addressed.

### 5.3 The Audit Committee's oversight of the SRA

81. The **Audit Committee (AC)** assisted and advised TLS's MB and TLS's Council in ensuring that the financial statements of TLS group (which included the SRA) were true and fair and complied with the applicable accounting standards. The AC kept the arrangements for internal audit, internal control, risk management and corporate governance under review, and advised generally on all aspects of audit and financial control within TLS.

#### The SRA's concerns

82. Through its representations the SRA told us that it was concerned that the AC exercised control over its:

- financial management and control – it reviewed the SRA's accounts and the associated management judgements
- internal audit – it approved the internal audit programme, amended and added audits, and considered internal audit reports and management actions
- risk management – it scrutinised the SRA's strategic risk register at each of its meetings.

83. These were all issues the SRA considered impinged upon its Board's control of its resources and activities, and therefore impacted on its ability to govern regulation independently.

84. The SRA also noted that each Committee was attended by TLS Chief Executive (or their nominee) and therefore TLS had access to information about performance and risk management which it should not have had as the representative body.

### The evidence gathered

#### *Reporting*

85. The AC had a group-wide remit and its terms of reference covered those matters set out in paragraph 81 and in Annex D. From the papers we saw the AC terms of reference and membership were not inconsistent with the UK Code of Good Corporate Governance (see Annex F).

86. During the relevant period we saw that papers related to the SRA's business activities, internal audit, and risk management were regularly considered by the AC in its role of overseeing the SRA. The AC also considered the SRA's financial matters through its review of TLS's annual report and accounts (i.e. when it was reviewing group issues on a consolidated basis). The papers relating to general risk management, internal audit and finance all fell within the AC's terms of reference.

87. As well as reporting to the Group AC, from early 2016, the SRA's Board established its own Audit Committee (the Finance and Audit Committee) and it therefore also had to report to its own Committee and fulfil its reporting requirements.

#### *Business updates*

88. We were told by the former Chair of the AC that the SRA's business updates were introduced by him to provide the AC with a clear line of sight on matters which should be brought to the Committee's attention. The SRA understood that the updates were introduced to provide some context to the AC's discussions on internal audits. The former Chair of the AC, TLS and the SRA agreed that no template nor specific instructions had been provided on what the updates should include. It was therefore the SRA's decision as to what was included. From reviewing the update reports we saw that the content varied over time. They included information on organisational change, business plan activities, project activities and, in the later reports, some key performance information. These reports were produced for each meeting and were similar in nature to those considered by the BOB.

89. The former Chair of the AC noted that during their tenure, neither TLS nor the SRA objected to providing the business updates. The current Chair of the AC questioned the value of these business update reports as they did not clearly meet the information needs of the AC. In their view, the AC needed to know (a) the budget and associated plan and (b) an update on how the priorities were

changing and how the organisation was responding to those changes. The SRA said that these business update reports led to a 'politicised' discussion about why the SRA was acting in a particular way. From our review of the papers we did not see evidence of the AC being a 'politicised' forum. However, we identified two potential questions that did not seemingly fall within the remit of the AC but arose because of the information provided in the business update (which was provided by the SRA by choice). These were the questions asked about the Financial Conduct Authority's approach to regulation in February 2016 and the request for sight of the LSB's regulatory standards report 2015/16 on the SRA in December 2016.

#### *Internal audit*

90. The Chairs of the AC were quite clear that overseeing the internal audit function fell clearly into the AC's terms of reference. (We note that it was within the terms of reference – see D6 of Annex D.) The SRA's internal audit reports were considered at each meeting of the AC. The reports covered plans for internal audits, progress made against the plans, outcomes of the audits, follow-up actions and the status of those follow-up actions. These reports were produced by the Group's internal audit team and subsequently by its outsourced provider and were informed by the risks facing each part of the Group.
91. We saw from the papers that the AC also made suggestions in December 2014, February 2016 and December 2016 for possible internal audits – these related to areas considered to be high risk such as a major supplier to the Group or areas where there were high financial costs. The current Chair of the AC also suggested that value for money audits could be carried out. It was not clear from our review of the papers what the outcomes of such suggestions were.
92. There was input and engagement with the SRA in relation to the internal audit activity. For example, it was consulted with on the content of the internal audit plans and the provisional findings of the annual assurance reports. However, we identified from the minutes of the AC meeting in December 2015 that the SRA raised concerns about the deferral of an internal audit (which had only been agreed two months before) without consultation.
93. The SRA did not raise specific concerns about the approach taken by the AC in relation to internal audit but, as noted at paragraph 82, had some general concerns. It considered that the AC should not have a role in the SRA's internal audit workstream as such a role impaired its independence, for it provided an opportunity for intervention by TLS on regulatory function matters. Further the SRA considered that internal audit was a subject which could be dealt with effectively through its own governance arrangements, and in particular, the Finance and Audit Committee.



## *Risk register*

94. The Chairs of the AC both told us that risk management fell within the terms of reference of the AC (as shown at D6 of Annex D). The former Chair of the AC told us that it was the AC's responsibility to ensure risk management processes were robust, that if a risk was identified, appropriate controls were in place and, if necessary, covered by audit and to consider if anything was missing from the risk register.
95. We have seen from the papers that the AC's means of reviewing the SRA's risks varied during the relevant period. Between October 2014 and December 2015, the AC reviewed the Group Risk Register from Corporate Solutions. The Group Risk Register presented risks that affected more than one part of the Group. Following the closure of Corporate Solutions, from February 2016 onwards, the strategic risk registers were provided by TLS and the SRA. These were meant to be presented quarterly, although we identified that the SRA did not provide a strategic risk register to the December 2016 meeting and that for the September 2016 meeting, whilst it was stated to be part of the papers, members did not receive a copy (although it did receive a risk paper from the SRA) because whilst provided by the SRA, it had not been included in the paper bundle disseminated by TLS.
96. The current Chair of the AC told us that the AC found it difficult to obtain a risk heat map from the SRA. They reflected that a possible reason for the reluctance was that the SRA did not consider the AC had a right to that information, given the SRA's recent establishment of its Finance and Audit Committee. We identified that the SRA's own delegation framework (May 2016) (the SRA Board Delegation Framework sets out how the SRA Board, its Committees and its Executive work together to discharge the SRA's functions) stated that only the BOB reviewed its strategic risk register.
97. The SRA told us that it considered that its strategic risk register was owned by its Board and scrutinised by its Finance and Audit Committee. In order for this to be a useful business management tool, it needed to be an open and honest document. The SRA was concerned that, by providing its strategic risk register to the AC, it was giving TLS access to information which should not be seen by those with representative functions. In practice, the SRA said that the impact of this was that its Board discussed matters which did not make it onto the register as the SRA did not want to expose them to TLS.
98. The SRA also told us, as part of its comments on the factual accuracy of the report that review of its risk register did not fall under AC's terms of reference, it fell clearly and explicitly to the BOB. It noted that the AC's terms of reference only included that the AC was responsible for 'keeping under review arrangements for risk management'. The SRA did not consider that this term gave the AC

responsibility for reviewing its risk register and the SRA had attempted to make this position clear to the AC Chair and the Committee in general.

### *IT transformation project*

99. The current Chair of the AC also raised concerns about the challenge the AC faced in receiving information about the SRA's and TLS's IT transformation programme. In their view, this project was the biggest risk facing TLS and without the AC's understanding how the IT project was working, it was unable to fulfil its role around risk management and internal audit (as noted at paragraph 81 it was within its terms of reference to keep under review arrangements for risk management and internal audit and to advise the MB and TLS's Council on all aspects of audit and financial control). However, they said it took repeated requests for information, from late summer 2016 to June 2017, before any information was presented.<sup>12</sup> The current Chair of the AC said they considered the SRA's reluctance to provide the information was because it did not see that this fell within the remit of the AC.

100. From the minutes we saw that, in June 2016, the current AC Chair noted their concern that the Committee had not been consulted about the IT roadmap (which then led to the IT transformation project), even though the cost of the project would be significant. In response it was said that a number of meetings had taken place relating to the project and that some AC members would have seen details of the project through their involvement in other Boards and Committees and that an item later in the agenda covered progress and more details regarding the project. We saw from the minutes that a later agenda item covered a report on the roadmaps produced, the related governance and costs; however, it was recorded that there was insufficient time for discussion of the report.<sup>13</sup> We saw that the AC repeated its request in September 2016 to have further information about the IT transformation programme when it asked the two Executive Directors with responsibility for shared services functions to report to the AC on how overall assurance of the IT transformation projects in the SRA and TLS would be provided and on the integration between the projects at its next meeting. A detailed presentation was provided alongside discussion at the December 2016 AC meeting.

101. The SRA told us as part of its comments on the factual accuracy of the report that the work on IT transformation was undertaken jointly by the SRA and TLS. It was dealt with on the SRA side through the SRA Board (and then BOB), on TLS side through the MB, jointly by SRA and TLS for the shared service aspects through BOB and ultimately, jointly by SRA and TLS to TLS's Council. The SRA noted that the governance arrangements that had to be navigated were complex

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<sup>12</sup> We acknowledge that February to June 2017 is outside of the relevant investigation period.

<sup>13</sup> We note that the management of the AC agenda regarding time allocated to items, and the time management of meetings themselves was outside the control of the SRA.

but that they considered the decisions regarding future IT developments were properly managed in accordance with the governance arrangements at the time. The SRA said that the decisions were not for the AC and the AC's terms of reference did not require it to be consulted on this work. The SRA noted that on several occasions, the AC Chair referred to, and criticised, the planned cost of the programme and insisted that the issue of the value for money of the programme should have been referred to the committee – even though there was no basis, or requirement, to do so given the AC's terms of reference. The SRA said that decisions on information provided to the AC were jointly made by TLS and SRA and that the SRA sought to provide the information the AC requested during 2017.<sup>14</sup>

### *Information requests*

102. The SRA raised concerns that TLS's Council's member on the AC made information demands of it, making the AC a 'politicised' forum. The current Chair of the AC said that personalities drove the contributions that AC members made and also noted that TLS's member may have made requests for supplementary information. However, they said that they had not had to intervene to prevent inappropriate questioning.

103. TLS stated that the AC had made no requests for information outside of matters related to the SRA's standard reporting requirements. During the relevant period we saw, from the papers reviewed, that additional information requests were made of the SRA. These were:

- December 2014 – the AC asked to see the strategic risk registers for each of the parts of the group alongside the group risk registers.
- February 2015 – the AC asked that in future a summary of the key risks from the individual TLS's, SRA's and Corporate Solutions' risk registers were presented with the group risk registers to provide clarity on the top risks across the organisation, rather than presenting risks that affected more than one part of the Group.
- February 2016 – the AC discussed the SRA's report of the review of the Oneview project, which detailed that an external review had highlighted a number of issues with the project and subsequently the SRA had decided to close it. The AC asked to see a copy of the external review report. The AC also asked for further information on the Financial Conduct Authority's approach to regulation and the drop-off in revenue reported.
- December 2016 – the AC asked for the LSB's regulatory performance review report; ongoing assurance over the IT transformation programme and to be

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<sup>14</sup> We note that part of the requests fell outside of the investigation period.

well-sighted on the work of the SRA's Finance and Audit Committee's work including sight of the minutes and regular dialogue with the Chair of that Committee.<sup>15</sup>

### *Effectiveness*

104. Both Chairs of the AC were clear that the oversight of the SRA was determined by being part of the same group structure and it was this group structure that placed clear parameters around the AC's terms of reference. Neither Chair thought that there was anything intrinsically difficult in making the oversight structures work effectively. It required people and a culture committed to doing so. They both agreed that in their view the SRA's independence or effectiveness had not been impaired by the AC. That said, the former Chair thought perhaps the SRA's efficiency had been affected by the overall governance arrangements because of the need for it to report to multiple Boards and Committees.
105. The Chairs had different views about the ability of the AC to carry out its role effectively during the relevant period. During the former Chair's tenure, the SRA did not have its own audit committee and the Group AC was focused on remedying significant issues with internal controls. The former Chair reported some initial difficulties in obtaining engagement from the SRA and TLS leadership on the internal control issues but that this had been resolved, and progress was being seen, by Easter 2015.
106. When the current Chair took over in January 2016, the SRA was in the process of establishing its own Finance and Audit Committee and the AC had made steps towards being a 'business as usual' audit committee. (According to the AC minutes, this started in December 2014 and progressed through 2015 as the Group addressed the internal control framework concerns.) The current Chair of the AC said that the AC had engaged with the SRA in a debate on the meaning of the AC's terms of reference and that it had had to remind the SRA that the terms were clear. The current Chair of the AC also said that there were risks facing the external members of the Committee because of the lack of co-operation and information being provided by the SRA. They said that the AC needed to have complete line of sight on matters which fell within its remit or it would not be able to fulfil its role.
107. The SRA told us that it considered the AC a 'politicised' forum and that its external members did not understand the nature of the relationship between it and TLS. The SRA also began from July 2016 to raise concerns with the LSB that it considered the AC was acting outside its remit. Managing the AC, in its view, took up a lot of time and effort.

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<sup>15</sup> We note that the Chair of the SRA's Finance and Audit Committee was a member of the BOB and not the Audit Committee.

108. We note that the last effectiveness review of the AC took place in 2013 and this had a positive outcome. There had been no effectiveness reviews during the relevant period under investigation.

109. From our review of the papers we did not see evidence of the AC being a 'politicised' forum. However, we identified two potential questions that did not seemingly fall within the remit of the AC but arose because of the information provided in the business update as noted in paragraph 103 (request for information about the Financial Conduct Authority's approach to regulation and a request for the LSB Regulatory Standards report 2015/16).

#### 5.4 The Remuneration Committee's oversight of the SRA

110. The **Remuneration Committee (RemCo)** made recommendations to the relevant Board on the pay policy, terms and conditions, incentives, severance payments and performance management frameworks in place for the Chief Executives of TLS and the SRA and their Senior Management Teams. It also made recommendations to the BOB on the remuneration, terms and conditions of the SRA's Board and Chair.

111. In early 2016, the SRA Board established a People Strategy Committee. Part of its terms of reference were (subject to the Group Remuneration Committee's role) to 'advise the Board on appointment, remuneration, performance and appraisal processes and contractual matters relating to Board Members, committee members, external advisory members and the Senior Management Team.'

#### The SRA's concerns

112. The SRA told us that it was concerned that the RemCo:

- impinged on the SRA Board's control of HR matters such as setting the performance management framework for the Chief Executive and Senior Management Team
- damaged its ability to regulate independently by requiring sight of, and considering the content of, the forward-looking objectives of the SRA's Chief Executive and Senior Management Team.

#### The evidence gathered

##### *Scrutiny by the RemCo*

113. It is accepted good corporate governance to have a RemCo in place. The Group's RemCo generally complied with good practice in terms of its role and responsibilities as set out in the UK Corporate Governance Code (see Annex F). However, we did identify two issues. The first that membership of a RemCo is normally limited to external members but TLS's RemCo had representatives from

both the SRA and TLS although neither had voting rights. The second issue was that a RemCo does not normally have a role outside of performance-related pay in relation to performance frameworks but TLS's RemCo had a role in reviewing performance frameworks for the Chief Executives of the SRA and TLS and the senior management reporting to them.

114. During the relevant period we saw that papers related to the following matters were considered by the RemCo: changes to its terms of reference, remuneration and performance reviews, annual salary and bonus awards process, the outcomes of the group award and recognition project, the annual pay and bonus recommendation template and the alignment of executive pay and performance cycle to the financial reporting year. These topics fell within the RemCo's terms of reference.
115. We also saw that the RemCo had discussions with the SRA outside of the meetings. These related to the following matters: clarity around the budgeting and benchmarking process used for pay and bonus of the SRA staff and senior directors (following its being devolved under Shared Services), the need for the objectives of the Chief Executive and senior managers to link more clearly to areas for improvement noted in previous performance assessments, and the possibility of including an objective for the SRA's Chief Executive (and TLS's Chief Executive) related to maintaining effective working relationships between the two organisations. These fell within the RemCO's terms of reference.
116. We saw from minutes and correspondence that these matters were raised by the RemCo to: ensure consistency of approach across the Group, enhance the evidence base of the RemCo's recommendations, ensure that there were 'stretching' objectives contained within the senior managers' performance framework rather than just being a reflection of 'business as usual' activities, and to address concerns that the external members had about the impact on public confidence of the poor relationship between TLS and the SRA being played out openly.
117. In terms of the discussions held outside the meetings, we note that matters relating to the Chief Executive's and senior managers' performance objectives caused the SRA some concern. The SRA raised this with the LSB as an example of the RemCo overstepping its remit. The SRA also raised this directly with the RemCo's Chair, in correspondence that we have seen. The Chairs of the SRA and the RemCo subsequently met to discuss this. At this meeting, the Chair of the RemCo said that they made it clear that the Committee was only asking for information to allow it to meet its terms of reference. We note from the correspondence we saw that the RemCo went through a similar process with TLS in terms of making information requests and suggesting the same objective.

118. The Chair of the RemCo told us that, after the SRA had described the remit and operation of its People Strategy Committee, they felt that the RemCo could take confidence from this. In their view, this assurance meant the RemCo could be less prescriptive in its scrutiny.
119. General Regulation 52(6)(a) sets out that the RemCo makes recommendations to the BOB after consultation with TLS on the remuneration and terms and conditions of the Chair of the SRA. TLS told us that this consultation took place within the meetings and discussions of the RemCo (we note that this meant a TLS representative was involved in these discussions – the Chair of the MB). However, the General Regulations stated that only the external members had voting rights, so it was their decision on what to recommend in relation to the remuneration and terms and conditions of the SRA Chair. This view was echoed by the external members of the RemCo when we met with them.

### *Effectiveness*

120. The RemCo's external members considered that the Committee had been effective in its role. It was said that it did not generally experience similar difficulties to the BOB because there was a vested interest in the Committee being successful and it was not looking at operational performance.
121. From our review of the papers, we saw that the RemCo was able effectively to fulfil its terms of reference, with the only area of significant dispute in the relevant period being the one described at paragraphs 117–118.

## **5.5 Interaction between Committees, the BOB and TLS's Council**

122. It is good corporate governance for each board/committee to have full knowledge of the deliberations of other committees (see guidance for Audit Committees, Financial Reporting Council April 2016 and the Financial Reporting Council Guidance on Board Effectiveness March 2011).<sup>16</sup> TLS's General Regulations provided for a range of formal interactions between TLS's Council, the BOB and the relevant Committees.

### *Interactions with TLS's Council*

123. The BOB, the AC and the RemCo all reported to TLS's Council as part of TLS's governance arrangements.
124. From our review of the papers, we identified that the BOB reported to TLS's Council after each of its meetings, but the purpose of the BOB's reporting to

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<sup>16</sup> <https://www.frc.org.uk/getattachment/6b0ace1d-1d70-4678-9c41-0b44a62f0a0d/Guidance-on-Audit-Committees-April-2016.pdf> and <https://www.frc.org.uk/getattachment/11f9659a-686e-48f0-bd83-36adab5fe930/Guidance-on-board-effectiveness-2011.pdf>

TLS's Council was not detailed in any governance documentation. TLS told us that the BOB, like other TLS Boards and Committees, exercised functions on TLS's Council's behalf. Its functions included exercising TLS's oversight, as an AR, of the SRA and Shared Services. Its reports were generally for noting rather than action or decision, and it was not customary practice for any actions to be taken by TLS's Council in response to the BOB reports.

125. From our review of the reports made to TLS's Council, we note that they generally covered the activities of the BOB, but that the level of detail provided about topics discussed, and the scrutiny and challenge posed by the BOB, decreased over time. This began following the departure of the first independent Chair of the BOB. When we spoke to the BOB's external members, they all knew that reporting to Council took place but there were different views on whether the BOB was kept informed of any questions posed by TLS's Council.
126. From our review of papers, we identified two instances during the relevant period where there were only two external members (instead of three) and no independent Chair of the BOB. During these times, it was agreed that the BOB would be jointly chaired by the SRA Board Chair and TLS President during the meetings. When reporting to TLS's Council on its activities, only TLS presented the Board's reports; this also happened on a couple of occasions when the second independent Chair was unable to attend TLS's Council meeting during 2016. That Chair told us that this is because TLS had not advised them of the date of the meetings.
127. The AC reported to TLS's Council annually. During the relevant period, TLS's Council received two reports which followed a standardised template and described the activities of the Committee over the previous 12 months. These were presented by the Chair of the AC. Both the Chairs of the AC said that, when presenting the annual reports to TLS's Council, they had not been subject to questioning about the SRA or the AC's oversight of it. This is supported by the minutes we have reviewed.
128. The RemCo provided an annual report to TLS's Council and the Chair attended a meeting to present the report and respond to any queries. During the relevant period, TLS's Council received two reports, in May 2015 and October 2016, which followed a standardised template and described the activities of the Committee over the previous 12 months.
129. Both Chairs of the RemCo reported to us that TLS's Council meetings were challenging because Council members had asked questions or requested more information about the work of the RemCo than they had been willing to provide. This included requests for the detail of any severance payments made during the year. Both indicated that they were capable of responding appropriately within the governance arrangements.



130. We saw from the June 2015 minutes of the RemCo that the Chair of the RemCo said they were challenged about the bonuses paid to the Chief Executives of the SRA and TLS and that TLS's Council were concerned to ensure that in determining and agreeing the bonuses due process had been followed. In the minutes of the December 2016 RemCo's meeting we also saw that it was reported that TLS's Council was keen to ensure that the RemCo had sufficient remit to undertake its role.

#### Interactions between the BOB and AC

131. The AC could report to the BOB on matters which fell under its own remit around the oversight of the SRA. According to regulation 44 of the General Regulations, the AC had a responsibility to report to the BOB in relation to internal and external audit.

132. From our review of the papers, we saw that papers were considered by both the AC and the BOB on matters which were of joint concern between December 2014 and December 2015, these covered issues such as the internal controls project (up until April 2015), accounting conventions, the review of Corporate Solutions, the group risk framework and group reward framework. From December 2015 onwards (following the closure of Corporate Solutions), the extent of the parallel reporting appears limited to a report on Shared Services, the IT transformation programme and the SRA's strategic risk register. We did not see matters relating to internal audit being reported to the BOB directly from the AC, although the BOB did receive high level information on the management, progress and outcomes of the internal audits from Corporate Solutions and then Shared Services.

133. Despite papers being considered by both bodies, there was limited evidence of interaction between the BOB and the AC. One BOB external member told us that they had no exposure to the AC but were aware of the tensions caused by the requirement for the SRA to report on its strategic risk register to both the AC and the BOB. Another said that they had not had exposure to the AC since 2015 and that they had not seen any information related to the SRA's internal audits which meant that the BOB was unable to do its job and oversee the SRA's performance. The other two external members of the BOB (who had also acted as Chair of the BOB) noted that there had been some interaction with the AC on specific matters such as the internal controls work and the duplication of reporting in relation to the strategic risk register.

134. The former Chair of the AC said that they had not got support from the BOB on matters which fell under both Committees' remits, such as the internal controls project, but they had attended some of the BOB meetings in relation to this matter. The current Chair of the AC said that they had had no contact with the BOB nor had they seen the BOB's terms of reference. They had met the former Chair of the BOB once, shortly before that person's tenure came to an end. We

note that the first Chair of the BOB disputes this view and states that they gave all the support requested and invited the then Chair of the AC to the BOB meetings.

135. One BOB external member said that a potential cause of the lack of clarity in the interactions between the AC and the BOB was that the governance reporting requirements were outside of established practice. Normally, the RemCo and the AC would report to a board like the BOB, but in this scenario they reported to TLS's Council.

### Interactions between the BOB and RemCo

136. We saw from the papers and the General Regulations that there was a clear line of sight between the RemCo and the BOB. It appeared that this was due to common membership, the clearly defined role and responsibilities of the RemCo and better administrative support.

137. The RemCo made recommendations to the BOB in respect of the remuneration and terms and conditions of the SRA's Board members and Chair. For example, in October 2014 it recommended to the BOB that the remuneration for SRA Board members should be increased from £10,000 to £12,500 per annum, the number of days of commitment specified in the contract should increase from 16 to 20, and that the additional allowance for Committee chairs should remain at £5,000. This recommendation was accepted by the BOB.

138. The RemCo also made a recommendation in February 2015 to the BOB regarding the proposed remuneration and time commitment for a Vice-Chair for the SRA Board (this would have been a new post). It was noted that the RemCo unanimously supported the proposals. The BOB approved this recommendation but, as noted in paragraph 72, TLS's members of the BOB stated that until the governance around this role had been clarified, it agreed in principle but reserved judgement on the appointment of a Vice-Chair.

## 5.6 Administration of oversight arrangements

### Terms of reference

139. From our review of the papers, we identified that the BOB had two sets of terms of reference during the investigation period. The differences between them were minor and related to the BOB's responsibilities around management and remuneration of senior executives at the now closed Corporate Solutions. TLS said that the current terms of reference were officially adopted on 27 March 2013 and that changes to them had not been formally sought or approved since. Instead it said that it appeared that on occasion the terms of reference were unofficially amended to reflect non-material changes and that these were attached to the meetings of the BOB papers. We note that the terms of reference

were not updated following the closure of Corporate Solutions nor following the changes in approach to the appointment and reappointment of the SRA Chair and Board members, which were required following the changes to the IGR in April 2014.

140. There were two sets of terms of reference for the AC during the relevant period. The establishment of the BOB in 2011 changed the terms of reference for the AC, although the former Chair of the AC told us that the AC was not informed of this and therefore did not adopt the revisions. That said, whilst we note that there was no direct reporting from the AC to the BOB during this period, there was limited parallel reporting (see paragraphs 131–135). Further changes were made in July 2015. These were all broadly in line with the UK Code of Corporate Governance and covered those matters that would fall within an AC’s remit such as the appointment and oversight of external auditors.
141. TLS reported that there were two terms of reference for the RemCo during the investigation period. However, our review of the papers showed that there were three:
- October 2014 – the first set of terms of reference.
  - March 2015 – the second set of terms of reference. This introduced the need for the BOB’s agreement to per diem rates for contractors in executive and Chief Executive roles.
  - October 2016 – the third set of terms of reference. This removed reference to the Chief Operating Officer and staff reporting to them following removal of this role and Corporate Solutions.
142. The current Chair of the RemCo noted that, in March 2016, the Committee had asked TLS’s Council to approve changes to the March 2015 terms of reference. However, a decision had not been forthcoming. They said they therefore took the opportunity, when presenting the annual report in October 2016, to seek Council’s approval and to ask that such matters are dealt with more quickly and efficiently in the future. The third set of terms of reference were approved at that Council meeting.

## Recruitment

143. It is good corporate governance practice for there to be robust recruitment processes in place for members of boards and committees (see Annex F). The external members were recruited using established recruitment practices for such non-executive positions (eg the use of search firms, applications and interviews). From reviewing the advertising and application paperwork we saw that, whilst there was mention of the SRA being the regulatory arm of TLS, it was only the

most recent campaign that provided an explanation of regulatory independence and the relationship between the SRA and TLS.

144. From speaking with the BOB's external members we note that, during the recruitment process, they understood why the BOB had been established but for some, the extent of the tensions with the implementation of the BOB were only alluded to through questions at interview around mediation and collective board decision-making. They gained a clearer understanding through meetings with executives post-appointment.

145. The current Chair of the AC said that much of their understanding of the relationship between TLS and the SRA came from the former Chair of the AC and the Chair of the MB. The specifics of this relationship were not explained during the recruitment process. We note that the former Chair of the AC was appointed to their role at TLS before the Act came into force in 2008 and was therefore aware of the relationship between the two organisations.

### Induction processes

146. It is good corporate governance to have robust and tailored induction and training programmes for board and committee members (see Annex F).

147. TLS said that external members were offered an induction programme for those who wished to have one, including visits to the SRA's offices and meetings with key members of staff. This was offered on a voluntary and indefinite basis. The SRA said that it became involved with induction at the request of TLS but there was no fixed programme of induction activities.

148. From speaking with the BOB's external members it is clear that following their appointment, they all had an induction in line with TLS's description but it was noted by two of the members that the induction was not as formal, structured or good as they had had with other organisations.

149. The current Chair of the AC said that there was little by way of induction outside of meeting with the Chief Executives, the SRA Chair and TLS President and they were provided with terms of reference for the AC but not for the other parts of the governance arrangements. We note that the minutes of the December 2016 AC meeting noted that one member of the AC who had recently attended TLS's 'Working in Partnership' induction programme felt it had not given sufficient coverage to issues specific to the AC. TLS offered to meet with the new members of the AC to provide a more specific induction for them.

### Succession planning

150. It is good corporate governance for there to be orderly succession-planning for boards and committees (see Annex F).

151. We note that, during the relevant period, there were two periods when there were only two external members on the BOB: September–December 2015 (this covered three meetings) and December 2016–Summer 2017 (this covered one meeting in the relevant period) (see paragraph 126).<sup>17</sup> This was despite TLS being aware of when members' terms of appointment came to an end and TLS and the SRA turning down the offer made by the first Chair of the BOB to stay in post beyond the end of their term of office. Some of the BOB's external members that we spoke to raised concerns that the quality of succession planning made the BOB less effective and one member noted that they had raised concerns at the time.

152. When the current Chair of the AC took up their role in January 2016 they immediately had to recruit to fill vacancies for three external members. It took until summer 2016 for those roles to be filled. We note that there would also have been a gap in the role of Chair of the AC had the former Chair not agreed to stay on between August and December 2015.

#### Administrative support

153. Consistent and competent administrative support is necessary for effective governance committees. The BOB's external members were consistent in their feedback about the quality of the administrative support provided. It was agreed that, prior to the closure of Corporate Solutions, the administrative support (agenda setting; delivery, quality and timing of papers and the accuracy and reliability of minutes) had been good. The first independent Chair of the BOB said that there had been a clear understanding that all papers went out a week before meetings and budget submissions were provided a month beforehand. However, since that time, members told us, and we saw from the minutes, that the service provided had been generally in need of improvement. In practice this was seen through settled meeting dates being rearranged several times, the minutes frequently being of a poor quality requiring correction and redrafting before they were agreed (although two external members told us that due to the extent of repair needed, the corrections and redrafting did not always address every error in the minutes), and papers being late or tabled at the meetings. The members said that this had not helped the BOB's ability to undertake its role effectively.

154. The former Chair of the AC considered that the administrative support for the AC was good at the start of their tenure but subsequently fluctuated and at times was poor. The current Chair of the AC said that the administrative support had required improvement during the relevant period; agendas and Committee packs had not been managed as well as they could have been and the minutes of the meetings were not orderly nor a proper record of discussions.

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<sup>17</sup> We note that the period 16 February to June 2017 is outside of the scope of the investigation.

155. From a review of the minutes of the RemCo we saw that these were agreed as an accurate representation of the discussion and decisions made at the Committee with only occasional clarification points raised by members. The current Chair of the RemCo commented that there was a settled timetable for the Committee and contrasted this with the BOB. The RemCo timetable was aligned to key points in the calendar related to its work around remuneration and performance frameworks. However, despite this settled timetable, they noted that the administration of submission of some papers could be improved so that they were received in a timelier manner.

## 6. Impact of oversight arrangements on the SRA's effectiveness and independence

156. In this Section we consider the combined impact of the operation of the four parts of the oversight arrangements on the SRA's effectiveness and independence. We address effectiveness followed by independence. In both parts of this Section we set out the SRA's generalised concerns about how the arrangements impaired its effectiveness or independence, our analysis of the evidence gathered and our conclusions based on that evidence.

### 6.1 Effectiveness

#### The SRA's concerns about the combined impact of the arrangements

157. The SRA raised concerns that the arrangements in place impaired its effectiveness as they were:

- 'neither transparent nor proportionate'
- 'complex'
- 'extensive in the level of intervention into the operation of the SRA Board permitted'
- 'in some places unclear'.

158. It said the level of scrutiny, by multiple Boards, Committees and TLS's Council was not proportionate to the respective roles and responsibilities of the SRA's Board and TLS's Council. It said that this impaired the effectiveness of the performance of regulatory functions by: creating excessive and time consuming multiple reporting and meeting attendance requirements; obscuring accountability; and creating delay where important matters, such as the SRA budget, required multiple levels of approval.

#### Our analysis

##### *The oversight arrangements*

159. The SRA was subject to scrutiny by a range of Boards, Committees and TLS's Council due to:

- the inherent statutory tension in the residual role
- TLS's view of how it should fulfil its residual statutory role under the Act

- TLS's choices about how it managed its group structure given its desire to maintain consistency with the UK Corporate Governance Code.<sup>18</sup>

The evidence showed that this combination of factors created tensions in the operation of the oversight arrangements.

160. The first tension arose from a difference in view between the SRA and TLS about how TLS fulfilled its residual statutory role. This was a tension that was, to some extent, a consequence of TLS (as AR) having a legal responsibility for regulation but being required to ensure that regulation was delivered independently of representative interests. Whilst this tension had been an undercurrent throughout the relationship between TLS and the SRA (as evidenced in our interaction with both bodies in our oversight role), it was clearly and transparently articulated in a paper produced by TLS and the SRA on the role of the AR which was presented to the BOB in March 2016. In this paper, it was noted that the SRA considered that TLS's role was limited to seeking assurance that the SRA was carrying out its functions in accordance with the Act and holding the SRA to account for adhering to sound governance principles. However, the report also noted that TLS took a broader view of its role and considered its role to also be about monitoring the SRA's performance in achieving the SRA's own strategic aims, and the efficiency and effectiveness with which the SRA operates and executes its policy decisions.
161. The second tension arose because of the need to reconcile good corporate governance with the IGR. From the recruitment material we saw, the external members of the AC, RemCo and to an extent the BOB, were all appointed to carry out customary non-executive director roles on these bodies. The recruitment material did not explain the relationship between TLS and the SRA and the concept of regulatory independence. We also note that overall the induction the members experienced was not routinely tailored to the nature of the Committee/Board they were appointed to nor to the nature of the relationship TLS had with the SRA under the Act. From speaking with the external members, it was clear that they had experience of undertaking non-executive director roles in other organisations and wanted and expected to fulfil their individual roles within the group structure but this did not necessarily reflect what was needed in light of TLS's residual statutory role. It was also clear that generally, they were unaware until in post of the extent of the tensions the Board and Committees faced because of the regulatory settlement.
162. Alongside recruitment and induction, the reporting requirements also created complexity. From our review of all the evidence, it was clear that there was duplication in the reporting requirements and that it was commonly known amongst the external members that this was a cause of concern for the SRA.

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<sup>18</sup> The SRA's view is that the structures in place were not in accordance with good corporate governance.



There was duplication in the reporting in relation to the SRA's strategic risk register, performance information, Shared Services and major projects. However, whilst we saw that the information provided was largely similar, we also saw that each Board/Committee was considering the information from a different perspective.

163. We also saw from the papers, and from speaking with the external members that this duplication was compounded by the infrequent interaction between the various oversight Board and Committees. This meant that limited assurance was being taken from the work being undertaken by other Boards and Committees both within the Group and in relation to the SRA's own internal governance committees (see Section 5.5).

164. We also saw from the papers and heard from those we spoke to, that these tensions caused disharmony and led to the role of the Boards and Committees in the SRA's work being questioned by the SRA. For example:

- The BOB had to be clear to the SRA and to TLS about its role in the Corporate Solutions review (see paragraph 64).
- There was discussion about the BOB's role in the IT transformation programme. We saw from the November 2016 BOB meeting minutes that the SRA indicated the BOB's role should be limited to the BOB being satisfied that appropriate programme governance arrangements and processes were in place, and to receive high-level reports on progress, rather than to intervene in decision making (see paragraph 64).
- There was a debate with the SRA about the AC's terms of reference and what it should therefore see from the SRA (see paragraph 101 and 107).
- There was correspondence exchanged between the RemCo Chair and the SRA Chair regarding the performance objectives of the SRA Chief Executive and the extent to which the RemCo should be involved in the development of such objectives (see paragraphs 117–118).

165. Alongside this, the amount of information presented by the SRA to the BOB and AC about its performance in relation to its strategic risk register and key performance information decreased (see paragraphs 67, 68 and 95–97).

166. As well as the tensions noted at paragraphs 160–163, another challenge the oversight structures faced was the changes that occurred in the Boards'/Committees' focus and within the SRA's own internal governance over the relevant period. Changes occurred in the focus of both the BOB and the AC which were not reflected in their terms of reference. Following the improvement of TLS Group's internal controls framework towards the end of 2015, the AC achieved its aim (as stated in the December 2014 AC minutes) of a move to a

'business as usual' committee. Following the closure of Corporate Solutions, the BOB's focus moved from oversight of Corporate Solutions/Shared Services to the performance of the SRA. The overall consequence of this was that there was an increased focus on the SRA's performance by both the BOB and the AC. During the same period, the SRA decided to strengthen its own internal governance so that it had a People Strategy Committee (akin to the RemCo) and a Finance and Audit Committee. The consequence of this was it had to satisfy the reporting and meeting commitments of both TLS and its own governance bodies.

167. We note the SRA's view that a lot depended on personalities and behaviours for the arrangements to work effectively. The external members we spoke to said the arrangements only worked if there was a shared understanding of their purpose and a shared commitment to make them work. It appeared to them this was present when the BOB was first established but varied over time.

168. An example of how the approach advocated by the external members resulted in improving the SRA's effectiveness was the review of Corporate Solutions and its outcome. Corporate Solutions was formed as part of the arrangements which also established the BOB. Concerns were raised about whether Corporate Solutions was delivering what each part of the Group needed, whether there was sufficient accountability for performance and budget and whether it provided opportunity to consider different resourcing decisions. As a result of the concerns, a joint review was held by TLS and the SRA which led to separation of services and each part of the group gaining greater control. In the SRA's view, this improved its effectiveness. Notably such separation continues, and in particular, with the IT transformation programme.

### *The oversight arrangements in practice*

169. During the development of the IGR, we noted in our consultation document (March 2009) that 'no processes designed for monitoring should result in burdensome compliance mechanisms falling to the regulatory arm'. We noted in our December 2011 assessment letter that the arrangements (which are those under investigation) were potentially compliant with the IGR but that we remained concerned as to whether the arrangements would be transparent and proportionate in practice.

### *Complexity*

170. TLS's General Regulations set out the oversight arrangements. The BOB was responsible for oversight of the SRA's performance of its regulatory functions and delivery of shared support services; this arose from the decision that it would be the body through which TLS exercised its AR responsibility. The AC and the RemCo had oversight roles which arose from the governance arrangements associated with TLS Group. All three exercised functions delegated by TLS's Council. TLS's Council also had a role in overseeing the SRA. From our review of

the General Regulations, we identified that those regulations which covered the oversight requirements were detailed in several different parts of the regulations equating to over 20 provisions. The complexity of the oversight arrangements is well illustrated by the diagram on page 16.

171. From our review of the evidence, we note that TLS Council had the power to substitute its complaints procedure for the SRA's if it considered that the SRA's was inadequate and it had the power to remove SRA Board members following a disciplinary matter. We were told in 2010 by TLS, as part of the self-certification process, that these powers were unlikely to be used and, if they were used, this would only be done, after consultation with or concurrence of the LSB. Our review of the evidence indicated that the General Regulations did not contain these assurances nor did they contain: all reporting requirements of the oversight bodies (they did not contain the need for the BOB to report after each meeting to TLS Council); nor all up-to-date terms of reference (the BOB's terms of reference were not updated post the closure of Corporate Solutions). This was despite TLS updating the General Regulations on a number of occasions since 2010.
172. Additional complexity was added because there was overlap between the Boards' and Committees' terms of reference, ambiguity in the terms of reference and limited interaction between those bodies meaning it was not clear who was responsible for which decisions or aspects of performance. This was particularly the case for oversight of risk where there was some disagreement about who should review the SRA's risk register. The SRA considered that this fell to the BOB as it was under their terms of reference but the AC also considered it to be part of how they fulfilled their term of reference related to keeping the SRA's risk management systems under review.
173. We also note during the relevant period there was internal recognition that the governance framework had shortcomings, which could be seen as casting doubt over its proportionality. Within the BOB's papers we saw that the adequacy of the governance arrangements to promote efficient strategic and operational management was recorded on the Group's risk register (until October 2015 when it was then the responsibility of each part of the Group to decide if such a risk should be included on their strategic risk registers). The consequences of the risk that the governance structures and practices were not agile were seen to be: over-reporting/duplication of reporting to multiple Committees; Chief Executive time to devote to key strategic issues was limited, an unrelenting reporting cycle, non-executive directors were overloaded with information so that key Committees did not scrutinise issues fully, important information was lost in the volume of data/reports, decisions were delayed, that it was not always clear who was responsible for decisions and that the governance framework did not always reflect what the Group did/needed to do. The Group risk register was managed by the Corporate Governance Team at TLS.

## *Efficiency*

174. During the relevant period, we saw from our review of the papers that there was scrutiny of a range of SRA matters through the oversight and monitoring arrangements. These were matters that were covered in TLS's General Regulations such as the BOB's and TLS's Council's review of the budget and net funding requirement papers. Some scrutiny of the SRA also arose from TLS Group issues (such as the internal controls framework) rather than directly from a regulatory function.

175. We saw that the terms of reference for the relevant Committees provided for overlapping roles and responsibilities. The multiple reporting requirements that arose as a consequence added time to the approval and decision-making process. From our review of the papers we identified the following examples of inefficiencies:

- Matters relating to internal controls and assurance were reported to numerous Committees (SRA's Finance and Audit Committee, BOB, MB and AC) before a decision was reached.
- There were delays in the BOB receiving recommendations on the Rewards Framework because each part of the Group was moving at a different pace.
- There was a delay of six months in the SRA's work on not collecting aged debts for some ABS being finalised (see paragraphs 72 and 210).
- There remained a requirement for the SRA to seek TLS's Council approval to its approach to appointments and reappointments to the SRA's Board and Chair positions due to TLS's failure to update its General Regulations and approach following changes to the IGR in April 2014 (see paragraphs 38–39).
- There was a requirement for the SRA to share with TLS's Council or its representatives, at various points, information about its rule proposals, including that the President should be sent a copy of the rule change seven days before it is sent to the LSB.
- The SRA's draft budget and net funding requirement was considered sequentially by the SRA Finance and Audit Committee, the SRA Board, the BOB and then TLS's Council. Between the BOB's and TLS's Council meetings, the budget and net funding requirement headline figures for the SRA were also considered by the MB as an element of the Group's overall net funding requirement. This all took place before the application to the LSB for approval under section 51 of the Act. There was then a second sequence following the same order of Committees and Boards where the final SRA budget was approved prior to the commencement of the financial year on 1 November.

## *Budget and internal processes*

176. In our IGR consultation document (December 2009), we envisaged that regulatory bodies should be responsible for proposing budgets which are thorough, well-argued and transparent. We also noted that the budget should be subject to a scrutiny process with robust checks and balances, which should ensure a fair and reasonable outcome whilst protecting regulatory independence. The SRA did not have full control of setting its budget. However, in line with the IGR there was a fair and transparent budget approval process in place which TLS and the SRA followed. The SRA had the ability to propose its own budget and to push-back any unwarranted challenge to its content and the process it had to use to seek approval was transparent. As noted in paragraph 60, this process did add time to the delivery and agreement of the budget but we did not see evidence of the arrangements preventing the SRA from having access to financial or other resources it required to deliver its regulatory strategy nor any interference in how it spent the money within its allocated budget when carrying out regulatory functions.
177. In relation to internal audit, the UK Corporate Governance Code sets out that ACs should monitor and review the effectiveness of internal audit activities. The terms of reference of the AC required that the AC receive and consider reports from staff engaged in the internal audit function. It is open to interpretation whether this requirement in the AC's terms of reference was necessary in light of the UK Corporate Governance Code or not. We note that the Chairs of the AC did not raise concerns about the interpretation of the AC's terms of reference but that the SRA did have some general concerns about the involvement of the AC in its internal audit work (see paragraph 93). We also saw from our review of the papers, one occurrence where the SRA was not involved in decisions relating to the internal audit schedule of the SRA (see paragraph 92). However, since the closure of Corporate Solutions we saw from the papers and from speaking with the SRA, that it had more control of its internal processes. Most services were led by the relevant organisation and the SRA had greater control over how they were managed. The remaining services, particularly IT, are moving to being business-led over the next few years.
178. Whilst it did have greater control than previously, the SRA told us that its approach to risk was hindered because of the oversight arrangements. It said that because its strategic risk register was seen by both the BOB and the AC and it had concerns about TLS membership of those bodies, there were matters which the SRA Board discussed which did not make it onto its strategic risk register. It appeared it was concerned that providing such information could provide an avenue to adversely influence the SRA or unfairly lobby in advance against possible SRA initiatives. In order for risk registers to be useful management tools they have to be comprehensive.

## *Resources*

179. The SRA told us that the demands of the oversight arrangements presented a resource issue as well as a governance issue. It said that it distracted the SRA Board, Chief Executive and other executives as papers had to be prepared and at least 10 meetings a year attended. This was in addition to its own governance requirements. We identified that there were occasional supplementary requests for information (for example, see paragraphs 49 and 103), and associated correspondence that arose from the oversight arrangements. This concern was also identified by TLS itself in its risk register as noted at paragraph 173.
180. In our review of papers we saw that often the same SRA work was used to service the multiple reporting requirements on operational, financial and governance performance. This may have been a way to address the resource demands imposed by the oversight arrangements. However, on occasion we saw that appeared to lead to further discussion or information requests because the reports were not tailored to the specific needs of the Committees. An example of this was the SRA providing business updates to the AC which covered similar issues to the Chief Executive's report to the BOB. These were not tailored to the need of the AC which was a) the budget and b) any operational changes which may impact on it. These updates then led to questions being asked such as that set out at paragraph 108.
181. We also saw that the oversight arrangements led to unwarranted reporting in relation to appointments to the SRA Chair and Board members (as explained at paragraphs 38–39). The IGR were amended by the LSB in April 2014 to move responsibility for managing the appointments and reappointments process to the regulatory body but TLS's General Regulations were not changed to reflect this. This meant that the SRA continued to seek approval from TLS's Council on its proposed appointments and reappointments process and decisions.

## *Pace of change*

182. The SRA also said that as well as an impact on time and resources, the oversight arrangements had an impact on the pace of regulatory reform as they had led it to take decisions to deprioritise areas of work. An example given of this concern was that the SRA thought funding for the Modernising IT programme could be jeopardised, through the budget approval role of the BOB and TLS's Council, if it established an anti-money laundering helpline for the regulated community because of the differing positions the SRA and TLS took on anti-money laundering regulations.
183. Whilst it was possible that there was an effect on individual policy initiatives, from our own review of the SRA's performance (see our Regulatory Standards

report 2015/16) we note that, we had not identified similar concerns.<sup>19</sup> In fact, we commented on the ambition demonstrated by the SRA and identified possible risks related to the management of the scale of changes proposed.

184. The external members of the BOB and the AC that we spoke to offered mixed views on the impact of the oversight arrangements on the SRA's effectiveness. Some saw no evidence of any impact. One said there may have been an impact on efficiency, because of the requirement to report to multiple Committees and the requirement to use Corporate Solutions/Shared Services. Another noted that while there may have been a reporting burden, in terms of the disruption it caused, they considered it had been at the "it's a bore" end of the scale, rather than anything that had inhibited effectiveness.

## Conclusions

185. The oversight and monitoring arrangements placed demands and obligations on the SRA, which together had a direct impact on the SRA's efficiency. Where disproportionate oversight and monitoring caused the SRA delay and impacted on resources we think it reasonable to conclude that the performance of its regulatory functions had been made less effective than it would otherwise have been.

186. Some demands for multiple reporting are to be expected in a group structure where there are wider obligations that flow from corporate governance around audit, risk, financial management and remuneration. Some are to be expected as a result of TLS's statutory residual role under the Act (not least because TLS is the body that will be subject to enforcement action if the SRA failed to be an effective regulator). However, this does not explain it all.

187. From our review of the evidence, it was unclear if some of the reporting demands were necessary given their impact on the SRA's efficiency. For example, should the:

- SRA's strategic risk register have been considered by both the AC and the BOB?
- BOB receive reports from both the Chief Executive and Chair of the SRA?
- AC have received a business update in its current form?
- Various oversight bodies all have had a role in reviewing and approving the draft and final budget and net funding requirement?

188. We are clear, however, that there was no basis for the reporting to, and seeking approval from, TLS's Council by the SRA on its appointments and

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<sup>19</sup>[http://www.legalservicesboard.org.uk/Projects/developing\\_regulatory\\_standards/pdf/1605\\_SRA\\_PERFORMANCE\\_REPORT.pdf](http://www.legalservicesboard.org.uk/Projects/developing_regulatory_standards/pdf/1605_SRA_PERFORMANCE_REPORT.pdf)

reappointments to its Board. TLS failed to update its General Regulations following our change to the IGR in April 2014. At that time we moved responsibility for the appointments and reappointments process from the AAR to the regulatory body. We also do not consider that there was a basis for TLS Council and its President to be notified at various points of the rules change process. This added in unwarranted reporting, additional time to the recruitment process which was unnecessary and the potential for delay to making changes to the SRA's regulatory arrangements. Further, as noted in our Bar Council/Bar Standards Board investigation report, it is important that there is transparency and clarity of decision-making between representative and regulatory functions (paragraph 2.90).<sup>20</sup> The arrangements noted in this paragraph did not provide either transparency or clarity to decision-making.

189. We saw limited evidence of the arrangements having a direct impact on the SRA's general effectiveness as a regulator as illustrated through the strategic risk register example detailed at paragraph 178. However, whilst its pace of regulatory reform may have been slower than it liked, we did not identify significant concerns with its regulatory performance during the relevant period, which we could assign to the governance arrangements. Nor did we find evidence that the lack of control over setting its budget was out of step with the IGR, or that TLS's oversight bodies used their responsibilities around finance and budget to limit the effectiveness of the SRA.

190. In our view the issues which led to the SRA's effectiveness being impaired were oversight arrangements which were complex and lacking in transparency. This was caused by:

- the lack of agreement between TLS, the SRA and external members as to the role of TLS as AR, and the mechanism through which it should check the SRA is acting in line with the Act
- a failure to integrate good corporate governance and compliance with the IGR in a holistic way.

191. The complexity and lack of transparency of the arrangements was evidenced by the:

- incomplete, out of date General Regulations
- overlapping and ambiguous terms of reference for the Boards and Committees

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<sup>20</sup> [http://www.legalservicesboard.org.uk/Projects/pdf/LSB\\_investigation\\_into\\_bar\\_council\\_influencing\\_of\\_the\\_BSB\\_\(25-11-13\).pdf](http://www.legalservicesboard.org.uk/Projects/pdf/LSB_investigation_into_bar_council_influencing_of_the_BSB_(25-11-13).pdf)



- a lack of clarity as to what each body in the oversight arrangements should do, see, discuss and how they linked with each other.

As a result, it could be unclear who was accountable for which decisions and for providing what scrutiny.

192. The issues set out at paragraphs 190 and 191 are well illustrated by the role and relationship of the AC and the BOB. Both carried out similar work, particularly in relation to review of the business updates/Chief Executive update reports and the strategic risk register, however, there was no real interaction between the BOB and the AC. The General Regulations did not include up-to-date terms of reference for the BOB (they still referenced the closed Corporate Solutions) and they did not set out its reporting requirements to TLS's Council. The terms of reference for the AC included in the General Regulations were open to interpretation which resulted in a lack of agreed view around whether the AC's responsibilities extended to reviewing the SRA's strategic risk register as part of the AC's role in keeping under review risk management arrangements. There was a further question of interpretation (see paragraph 177) regarding whether the term of reference of the AC relating to receiving and considering reports from staff engaged in the internal audit function was a necessary part of carrying out the responsibility noted within the UK Corporate Governance Code that audit committees should monitor and review the effectiveness of internal audit activities.

193. It is our view that the arrangements when implemented did not ensure that the principles of good corporate governance were balanced with the requirements of the Act (eg TLS's residual role as an AR) and the working environments in which the SRA and TLS found themselves. Instead these objectives were fighting against each other in the arrangements set out in the General Regulations. As we noted in the Bar Council/Bar Standards Board investigation, we would reasonably expect ARs/AARs to review processes and procedures to achieve progressive enhancements to independence (paragraph 2.81).<sup>21</sup> We did not see evidence of TLS undertaking such reviews and enhancements despite its own risk register highlighting concerns with the proportionality and efficiency of the governance framework, the SRA making changes to its internal governance framework and the change of focus of the BOB and the AC.

194. The complexity of the arrangements was compounded by the variable quality of the administration of the oversight bodies which meant often: papers were late, the minutes (post closure of Corporate Solutions) of the AC and BOB required redrafting and correction before they were agreed (and even then may not have accurately reflected every aspect of discussions at the meetings) and in the case of the budget approval, meetings were not organised in the sequence required for

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<sup>21</sup> [http://www.legalservicesboard.org.uk/Projects/pdf/LSB\\_investigation\\_into\\_bar\\_council\\_influencing\\_of\\_the\\_BSB\\_\(25-11-13\).pdf](http://www.legalservicesboard.org.uk/Projects/pdf/LSB_investigation_into_bar_council_influencing_of_the_BSB_(25-11-13).pdf)

smooth facilitation of the approval process (see paragraph 60). It was also not helped by:

- the failure to plan for orderly succession of chairs and members of the Boards and Committees which notably resulted in the BOB lacking an independent Chair for two periods within the period under investigation
- the failure of TLS to mandate the requirement for an independent Chair within the General Regulations
- the failure to tailor recruitment material and induction to the individual needs of the Boards and Committees within the oversight arrangements and the specific relationship between the SRA and TLS.

195. Finally, the difficulties of the arrangements were also fuelled by the mixed levels of commitment to them by the SRA and to some extent TLS. In 2011 the BOB was a jointly agreed mechanism through which TLS would hold the SRA to account. However, it was clear that there was no longer the same joint commitment to the BOB. This was demonstrated through a decline in the detail of reporting by the SRA to the BOB, reluctance by the SRA to provide the AC with information, the SRA's questioning of the role of the BOB, the AC and the RemCo in its oversight, the BOB's exclusion from matters which clearly fell within its remit and the lack of insistence by the SRA and TLS on having an independent Chair in place (see paragraphs 77, 126 and 151).

## 6.2 Independence

### The SRA's concerns about the combined impact of the arrangements

196. The SRA raised concerns about the arrangements in place providing the opportunity for its independence to be impaired as they permitted multiple levels of, and opportunities for, intervention in the performance and management of regulatory functions. It provided the following examples in its letter of 30 September 2016:

- 'the AC's responsibility to scrutinise internal audit reports on the operation of regulatory functions and the SRA's strategic risk register, and in the view of the current AC Chair, conduct value for money scrutiny of operational activities'<sup>22</sup>
- 'the BOB's responsibility for all matters of budgetary control within the SRA'

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<sup>22</sup> The SRA subsequently clarified that, in its view, the AC did not have the responsibility to review the SRA's strategic register and that the AC sought to do so outside of its terms of reference. The SRA also pointed out that the AC's terms of reference do not refer to the AC having value for money scrutiny responsibilities for activities beyond external audit arrangements.

- ‘the RemCo’s responsibility for the performance management framework for the SRA’s Chief Executive and senior management group’
- the AC’s, the BOB’s and the RemCo’s membership included individuals with representative responsibilities.

197. The SRA said ‘the presence of these individuals allows multiple opportunities for involvement and intervention in the SRA’s discharge of its regulatory functions and the operational management of those functions.’ The SRA considered that governance arrangements should have robust safeguards built in through proper, transparent, separation of duties rather than relying largely on the independent state of mind of individuals to ensure regulatory independence. It said this was not the case during the relevant period.

## Our analysis

### Roles and responsibilities of the Boards/Committees

198. We detailed in Section 5 the role of each of the relevant oversight bodies and the reasons identified for their inclusion in the oversight arrangements. We do not repeat this detail here but we set out in summary the basis of their roles:

- TLS’s Council’s role was derived in part from TLS’s wish to act in line with the UK Corporate Governance Code (receiving annual reports from the RemCo and AC) and in part from TLS’s view of how it should fulfil its residual statutory role for ensuring the SRA carried out its delegated functions in line with the Act.
- The BOB’s role derived from a joint TLS and SRA piece of work (agreed by the SRA’s Board in October 2011) which led to its establishment and its role. It was the main Board through which TLS exercised its residual statutory role under the Act to ensure the SRA was carrying out its delegated functions in line with the Act.
- The AC and the RemCo’s roles were derived from TLS’s choice of governance structure (which was not inconsistent with the UK Corporate Governance Code) and the SRA being part of TLS group structure.<sup>23</sup>

### *Responsibilities*

199. We have detailed in Section 5 the responsibilities of each of the relevant oversight bodies. We set down below our views on the factors we observed that are relevant to an assessment of whether there was an impairment of the SRA’s independence and if so, the extent of that impairment.

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<sup>23</sup> We note that the SRA does not agree that the governance structures in place were consistent with good corporate governance.

200. TLS's Council's oversight responsibilities for the SRA were set out in the General Regulations and we have listed them at paragraphs 32–33. We note that TLS's Council having responsibility for reviewing and scrutinising the annual reports of the AC, the SRA and the RemCo was in line with good corporate governance given the group structure and TLS Council's choice of how it fulfilled its residual statutory role under the Act. We also consider that its role in scrutinising and approving the SRA's draft and final budget and net funding requirement was in line with the IGR as explained at paragraph 176.

201. In reviewing the General Regulations we identified that they provided TLS's Council with opportunities for involvement and intervention in the performance and management of the SRA's regulatory functions.

- These were that it had powers under:
  - Regulation 31(23)(c) to require litigation related to the discharge of the SRA's functions to be dealt with by the MB.
  - Regulation 32(1)(d) to issue a direction requiring a rule proposal to not be implemented.
  - Regulation 34(6) to remove a member of the SRA Board.
  - Regulation 34(7) to substitute its own procedure for investigating and determining complaints if it believes that the procedure established by the SRA Board is inadequate.
- It also required the SRA Board under:
  - Regulation 30(2) to seek approval for any appointments and reappointments to its Board. This is not in line with changes made to our IGR in April 2014.
  - Regulation 32 to involve TLS at various stages of the rules change process including sending such changes to TLS President seven days before the rule change is submitted to the LSB.
- It also required the BOB to report after each of its meetings to TLS's Council. The need for this was not recorded in any governance documentation nor was the rationale clear for the difference between this reporting frequency and those for the AC and the RemCo (they reported annually).

202. Whilst TLS's Council had retained these powers, we did not see evidence that it used them to impair the SRA's independence during the relevant period.

203. The BOB's oversight responsibilities for the SRA were set out in TLS's General Regulations and are noted at Annex D. We note that its responsibilities were in line with the IGR, including in relation to the setting of the SRA's budget.

We did not identify that the BOB's oversight responsibilities as set down in the General Regulations provided direct opportunity for TLS to impair the SRA's independence.

204. The AC's oversight responsibilities for the SRA were set out in TLS's General Regulations and are noted at Annex D. We note that its responsibilities were not inconsistent with the UK Corporate Governance Code, including its review of internal audit arrangements, its review of arrangements for internal controls and risk management and advising on the appointment of external auditors (see Annex F). We did not identify that the AC's oversight responsibilities as set down in the General Regulations provided direct opportunity for TLS to impair the SRA's independence.

205. The RemCo's oversight responsibilities for the SRA were set out in TLS's General Regulations and are listed at Annex D. We note that its role in making recommendations to the SRA's Board and the BOB on pay (including bonus, incentive and severance pay), terms and conditions, and pay and bonus policy were in line with good corporate governance (see Annex F).

206. However, in reviewing the General Regulations we identified that they provided the RemCo with some unnecessary opportunity for involvement and intervention in the performance and management of the SRA. These were:

- Regulation 52(2) set out that the RemCo makes recommendations to the SRA Board on the performance management frameworks for the SRA Chief Executives and the senior managers reporting directly to him. While its power was only to make recommendations which the SRA Board could choose to accept or not, this does not normally fall under the remit of a RemCo (when reviewing the guidance set out in the UK Corporate Governance Code – see Annex F) outside of determining performance conditions.
- Regulation 52(6)(a) set out that the RemCo makes recommendations to the BOB, after consultation with TLS, on the remuneration and terms of conditions of the Chair of the SRA. It is not clear why the consultation with TLS was necessary for this role.

207. Whilst the RemCo had these powers and membership, we saw no evidence that it used these opportunities to impair the SRA's independence during the relevant period under investigation.

208. We also note that the membership of the RemCo included a representative each from the SRA and TLS alongside the three external members. This was contrary to good corporate governance (see Annex F) as there should not be any representatives from the organisations on such a committee.

## Scrutiny and challenge by the Committees, Board or Council

209. There were consistent messages from those that we spoke to, including the SRA's Chief Executive, that there had been no specific incidences of TLS's oversight arrangements impairing the independence of the SRA through its scrutiny and challenge.

210. Examples were provided by external members of the BOB and identified from our own review of papers, which indicated there may have been a small number of occasions when the scrutiny and challenge had the potential to stray from oversight to influence but were prevented by the checks and balances in the system. By this we mean that the independent Chairs of the BOB or the AC were able to prevent any influence being exerted having a material effect on the SRA's independence or that the SRA were able to defend its position as an independent regulator. However, the requirement for the checks and balances to be used in practice did cause friction in working relationships. Two examples of potential disproportionate scrutiny in practice are:

### *Non-collection of periodic ABS fees*

- November 2014 – the BOB was told that the SRA's Finance and Resources Committee was going to make a decision, at its meeting on 19 November, on whether, retrospectively, to collect some unpaid fees for 2011/12 from ABS. The BOB urged the SRA to consider pursuing the aged debts. It was felt to be of reputational importance. The SRA confirmed that they would incorporate the BOB's feedback into discussions at the Finance and Resources Committee.
- December 2014 – TLS's Council asked for further information on the SRA's rationale for not collecting the outstanding 2011/12 ABS fees. This request was made through the Chair of the BOB following their report to TLS's Council on the November 2014 meeting.
- February 2015 – the BOB were informed that the SRA's Finance and Resources Committee had decided not to collect the aged debts. There was strong discussion on this decision within the meeting and the Chair said they would share with TLS's Council a summary of the discussion through their regular report to them.
- February 2015 – TLS's Council was told by the Chair of the BOB that the SRA paper that had been submitted to the BOB on the request of TLS's Council had been discussed. The SRA had confirmed at the BOB meeting that the issue of the collection of the outstanding ABS fees from 2011/12 had been given serious consideration at their Finance and Resource Committee and by the SRA's Board. In summary, the view of the executive was that the cost, time, complexity and resources involved in collecting the outstanding

2011/12 fees outweighed the benefit of collecting them. The reputational risks of this decision had also been considered. It was reported that at the BOB a rigorous and challenging discussion on this decision had followed between the external members and TLS's representatives. As a result, the SRA Chair had agreed to revisit this decision; there would be a re-examination of this issue at the SRA Finance and Resource Committee meeting on 26 February and at the SRA Board meeting on 11 March. TLS's Council members felt that this was a serious regulatory issue and wanted to investigate it further. TLS Council expressed their concern and disappointment at the SRA paper but were pleased to hear it was being reconsidered as they felt the SRA's previous position was 'inappropriate'. TLS's Council hoped for a more positive (in its view) outcome. It was agreed that TLS's Council's position would be communicated back to the SRA.

- February 2015 – the issue of the non-collection of some ABS fees was discussed at the AC.
- April 2015 – the BOB was told that the SRA Board had considered it further but had reached a consensus confirming its original decision not to pursue the collection of the outstanding fees on the basis that there was no new evidence to justify a different approach.
- May 2015 – TLS's Council was informed of the outcome of the discussions at the BOB in April 2015 (through the regular report to Council). It was minuted that the President of TLS would write to the SRA about this issue; and that the BOB had done as much as it could, though it was recognised that the outcome was not satisfactory to TLS's Council.

211. This example appears to show that TLS's Council wanted to exercise greater control over the SRA than it was allowed to under the regulatory settlement. As we noted in the Bar Council/Bar Standards Board investigation, governance arrangements should deliver awareness and compliance at all levels within the organisation on an ongoing basis (paragraph 2.53). On this occasion, the lack of awareness of the limits of their oversight and monitoring roles did not impair the SRA's independence as the boundaries of the BOB's role were policed effectively by it. However, this exercise did cause delays to the SRA's decision-making and created additional work and therefore had an impact on the SRA's effectiveness as set down in Section 6.1 above.

#### *Messaging about the profession*

- November 2016 – at a BOB meeting in a discussion about investment schemes and consumer risk, TLS said that it was important messaging was proportionate because if the public lost confidence in the profession this would be damaging and not in the public interest. TLS therefore urged the SRA to ensure messaging reflected the small number of firms and individuals

involved (whilst not decrying the serious concern). The SRA noted that it had not sought to involve the press in relation to solicitors' involvement in these investment schemes, though schemes would be covered in the next Risk Outlook which would be discussed at the SRA Board, and in due course involvement in the schemes might give rise to SDT determinations.

212. This example shows that the SRA is able to defend its position as an independent regulator from any attempt by TLS, wittingly or otherwise, to influence its actions.
213. We also identified examples of potentially disproportionate inquiry by the oversight bodies, and again we note that the checks and balances prevented any inappropriate action being taken by TLS's Council and the AC. These are:
- March 2015 – a paper was presented on the renewal of the lease of the SRA's Martin Lane office by the MB Chair. TLS's Council was told that the renewal of the lease had been approved by the BOB and the MB following a preference expressed by the SRA to stay at the location. TLS's Council members challenged the decision to renew the lease and raised concerns about their lack of involvement in the decision-making. They were informed that the transactions relating to leases was within the remit of the BOB and MB and the paper was presented to TLS's Council for information only.
  - February 2016 – the AC asked for further information on the Financial Conduct Authority's approach to regulation. This arose from a discussion about the business update provided by the SRA but the subject did not fall under the AC's terms of reference.
  - July 2016 – TLS's Council asked TLS's Chief Executive to challenge the SRA's spending on events as TLS Council queried whether this was an appropriate use of funds. TLS's Chief Executive noted that it might be difficult to challenge the SRA on spending if the events were in furtherance of its regulatory purposes but the point could be raised with them.
  - December 2016 – the AC asked for the LSB's regulatory standards report even though this matter fell within the remit of the BOB. This arose from a discussion about the business update provided by the SRA but the subject did not fall under its terms of reference.
214. Whilst these could be considered examples of potentially disproportionate inquiry these were minor in nature and small in number, over an investigation period which covered 28 months.
215. Overall the views of the external members we spoke to were that there had been occasions in meetings where discussions had become heated around contentious subjects. However, they said they had been there to temper any



potentially inappropriate questioning or information requests by TLS executives or Council members. They did not consider that there had been a disproportionate level of inquiry, investigation and challenge which had gone unchallenged. The BOB external members highlighted the need to manage the oversight meetings appropriately in light of the risk of inappropriate questioning or information requests as a key reason that an independent Chair of that Board was vital (see paragraphs 77, 126 and 151).

216. It would be unrealistic to expect that on occasion a question that falls outside the remit of a governing body will not be asked. What is important is how such a question is managed so that it is not frequently repeated and does not impair a regulator's independence.

### Membership

217. The SRA raised concerns that the oversight bodies included members of TLS's Council and in some cases its executives and that this allowed for multiple opportunities for intervention and involvement in the performance and operation of its regulatory functions. For example, it said that both the AC and the BOB had TLS membership and both bodies reviewed the SRA's strategic risk register. This provided them with access to information that they should not have and an opportunity to adversely influence the SRA or unfairly lobby against possible initiatives such as statutory regulatory independence. As noted in paragraph 178 above, the SRA said that this led it to not include some issues which were discussed by the SRA's Board on the strategic risk register.

218. TLS performs representative and non-regulatory permitted purposes as well as oversight of the SRA's regulation. Therefore, individuals at TLS may perform a number of functions, not all of which will amount to representative functions.

219. We set out in Annex D the composition of each Board, Committee and TLS's Council in scope of the investigation. This shows that:

- other than TLS's Council (which is a body with a primarily representative function), the other Board and Committees also had external members and SRA membership
- other than TLS's Council, there was equal membership of TLS and SRA representation on each Board and Committee
- other than on the BOB, there were more external members than those from either side of the group.

220. The composition of the AC was in line with good practice as it was made up of at least three external members and had equal representation from the non-executive directors of TLS and the SRA. It may, however, have resolved some

issues regarding assurance of the SRA's performance if the Chair of the SRA's Finance and Audit Committee had been a member of the AC.

221. The composition of the RemCo was three external members, plus one representative each from TLS and the SRA. Only the external members had voting rights on the Committee. The function of the RemCo was to advise and recommend, rather than to decide. TLS, and the RemCo external members told us that if there had been disagreements amongst the members, the expectation was that they would have been discussed and resolved. In the event of a disagreement, only the three external members would vote on it. Whilst this seems like an appropriate safeguard, it is good corporate governance for there to be no representation from either body on the Committee.
222. Outside the balance of membership we also considered the SRA's argument that just by being members of the Boards and Committees, TLS representatives had access to information they should not have had about the performance of the SRA. We note that it was a small number of senior TLS representatives that were on the oversight bodies which the SRA raised concerns about (the AC, the BOB and the RemCo) – TLS's President, TLS's Treasurer (the Chair of the MB), TLS's Chief Executive and two members of TLS's Council (see paragraph 219 and Annex D). These representatives did have access to material that they generally would not otherwise have, and this did present a risk that material would be misused. However, we note that (outside of the RemCo which was discussed at paragraph 206) the presence of TLS representatives on the BOB and the AC was not unreasonable given TLS's choices in relation to its governance structure and how it chose to fulfil its statutory residual role. Further, we note that we did not see evidence that the information had been misused in practice during the relevant period.

## Conclusions

223. We did not see evidence that TLS's representative functions, through the oversight and monitoring arrangements, impaired the SRA's independence in its performance of regulatory functions.
224. In line with the IGR, TLS had some discretion as to how it set up its oversight and monitoring arrangements. Whilst we have found that there was no impairment of the SRA's independence as a result of the oversight and monitoring arrangements, we did find that they could have been established in a way that reduced the risk or perception of the SRA's independence being impaired. Further, as noted at paragraph 193, it was open to TLS to review the oversight and monitoring processes to achieve progressive enhancements to regulatory independence during the relevant period.
225. The oversight arrangements provided opportunities for TLS to be involved and intervene in the performance and operation of the SRA's regulatory functions.

Those opportunities are set out at paragraphs 201–208. We do not consider that there is a reasonable rationale for the existence of all of these opportunities. Those we have concerns about are: TLS’s Council continued role in the appointment and reappointment of SRA Board members, TLS’s involvement at various stages of the rules change process and its power to issue a direction requiring a rule change proposal to not be implemented, the requirement on BOB to report after each of its meetings to TLS’s Council and TLS’s Council power to require litigation related to the discharge of the SRA’s functions to be carried out by the MB. We found other examples of the wording of the General Regulations creating the potential for non-compliance with parts of the Schedule to the IGR, namely:

- A power for TLS’s Council to substitute its own disciplinary procedure for SRA Board members in place of the one proposed by the SRA. This power is relevant to Rule 2D of the Schedule to the IGR which states that decisions in relation to discipline of persons appointed to regulatory boards should respect ‘the principle of regulatory independence’.
- A power for TLS’s Council to remove a SRA Board member in relation to disciplinary matters. This power is relevant to Rule 2E of the Schedule to the IGR what states that except in certain circumstances no person appointed to a regulatory board should be dismissed without the concurrence of the LSB.

226. Whilst these two provisions of the General Regulations provided an opportunity for non-compliance, we note that during the relevant period there were no disciplinary decisions, nor dismissals, made by TLS in relation to SRA Board members. We also note that we were given assurances in 2010 that TLS would not use either of the above powers without consultation with the LSB or the concurrence of the LSB. Given the above two factors, we consider that there was no evidence that these two powers impaired the SRA’s independence nor was there evidence of them being used contrary to Rules 2D and E of the Schedule to the IGR.

227. In operating the oversight and monitoring arrangements, we note that there were occasions (see paragraph 210— 212) when TLS’s Council, the BOB and the AC’s scrutiny and challenge may have been considered disproportionate. However it appeared that the external members and the SRA itself were vigilant in policing the boundaries of TLS Council, the BOB and the AC’s oversight remit to prevent any undue influence on the SRA’s independence. This demonstrated that checks and balances in the arrangements were operating effectively in relation to maintaining the SRA’s independence, but there remains a risk that those bodies could go beyond their remits if these controls are weak or absent in the future. As we noted in the Bar Council/Bar Standards Board investigation, the governance arrangements should ensure that there is awareness and compliance at all levels within the AR/AAR around regulatory independence.

228. Further risks arose from the membership of the oversight bodies. There was TLS membership (Council/executive) on the oversight and monitoring bodies. This presented a risk to the perception of independence, a risk of inappropriate influence during discussions and debate about the SRA and a risk that those members may misuse the information they had access to about the SRA. We did not see evidence of these risks crystallising. Further we note that these risks need to be balanced against the fact that the AC is a group Committee and the BOB is the body through which TLS exercises its AR function. We have commented at paragraph 206 on our views in relation to the RemCo membership.

229. The SRA said that the oversight arrangements should not have had to rely on 'independent minds' (i.e. that it should not have had to rely on people carrying out their role with a clear understanding of regulatory independence) to ensure regulatory independence nor should the SRA have had to adopt a robust approach to drive reforms through the current arrangements. The need for independent minds and a muscular approach illustrates the fragility of the oversight arrangements in place to ensure regulatory independence. However, without full structural separation through a change in legislation such fragility in the arrangements will remain to a degree, and any new model short of structural separation may not fully eliminate that fragility. Although it is also important to note that the need for independent minds would still be a requirement even if there was structural independence because even independent regulators are lobbied by stakeholders including representative bodies. As we noted in our December 2009 IGR consultation document it is appropriate that representative bodies lobby regulatory bodies and seek to share their experience before regulatory bodies make policy decisions.

230. As with the complexity of the arrangements (see paragraph 194), the risks to the independence of the SRA's regulatory functions were not mitigated by:

- the failure to plan for orderly succession of chairs and members of the Boards and Committees, which notably resulted in the BOB not having an independent Chair for two periods within the period investigated. This presented an additional and unnecessary risk to the perception of the independence of the BOB and its oversight of the SRA
- the failure of TLS's Council to mandate an independent Chair of the BOB to reinforce the importance of independence to these arrangements
- the failure to tailor recruitment material and induction to the individual needs of the Boards and Committees within the oversight arrangements and the specific relationship between the SRA and TLS. Whilst the lack of such recruitment material and induction did not appear to have caused widespread

problems, it would have enabled external members to understand quickly the boundaries that should be respected because of the IGR.

## 7. Compliance with Rule 8 and the Schedule to the IGR

### Regulatory independence and the IGR

231. The Act does not create a framework in which all regulatory bodies are structurally separate from representative bodies. Rather, it creates ARs which may have both representative and regulatory functions. Our responsibilities include a duty to make IGR, setting out requirements ARs must meet to ensure the independent exercise of regulatory functions.
232. The production of the IGR was one of the first, and most important, tasks that we undertook on being established. In setting the requirements within the IGR, as with everything we do, we discharged our duty to promote the regulatory objectives and to have regard to best regulatory practice. Amongst other things, this meant that we had to reflect in the IGR the discretion the ARs had in arranging the structure of their regulatory arms in a way that fits their circumstances, and in a manner which they determine to be reasonably practicable. We could not use the IGR as a means to introduce institutional separation by the back door.
233. We also took an approach to drafting the IGR which is indicative of what could be termed an expansive approach, i.e. an AAR can do anything so long as regulatory independence is not compromised. This approach reflected the preference at the time the IGR were first drafted for AARs and regulatory bodies to have the opportunity to secure regulatory independence constructively.
234. In the IGR we specifically define the 'principle of regulatory independence'. The definition states that: 'structures or persons with representative functions must not exert, or be permitted to exert, undue influence or control over regulatory functions'. We define 'undue influence' in the IGR as 'pressure exercised otherwise than in due proportion to the surrounding circumstances, including the relative strength and position of the parties involved, which has or is likely to have a material effect on the discharge of a regulatory function or functions'. Independence in this sense is more than just structures.
235. The IGR have been in place for more than seven years. We are aware of some issues with their usefulness to the regulators delivering independent regulation as set out in our 2017 consultation on the IGR. We have seen some of these issues play out in the operation of TLS's oversight and monitoring arrangements of the SRA. These include, but are not limited to, the following:
- a lack of shared understanding about what oversight the AAR should exercise over its regulatory body. The ARs have a legitimate interest in being assured that regulation is being delivered in line with the Act but this must be balanced against the need for independent regulation

- the practical consequences of disagreements on independence including the time and resources of the AAR and the regulatory body being spent dealing with tensions around independence. This detracted from matters which could allow respective parties to deliver improvements for consumers, the profession and the public.

236. We have also identified, through the course of this investigation, similar concerns to those set out in our 2017 IGR consultation, about the interpretation and application of the IGR themselves. In the consultation we noted that those we spoke to told us that the language of the IGR is qualified, open to interpretation and difficult to apply in practice. Through our investigation we found issues that include, but are not limited to, the following:

- the relationship between Rule 6 and Rule 8 of the IGR could and should be stated more clearly. The need for both of these provisions relates to the requirement for Rule 6 to apply to all ARs and for Rule 8 to apply only to AARs
- the requirements within the Schedule could be more clearly set out so that our expectations of the applicable ARs are easily understood. The current framework of principles, rules and guidance which are presented in a table format causes unnecessary complexity
- the definition of the ‘principle of regulatory independence’ in the IGR may not best reflect the aim of ensuring regulatory independence
- the definition of the ‘principle of regulatory independence’ is not straightforward. It contains words which are further defined including ‘undue influence’; words which are open to subjective interpretation such as ‘relative strength and position of the parties involved’ and ‘pressure exercised otherwise than in due proportion to the surrounding circumstances’ and unclear terms such as ‘material effect’ or ‘likely to have material effect’. This has the potential to introduce confusion and can cause an unnecessary degree of complexity.

### Application of the IGR to the investigation

237. In this Section we set out our views on whether TLS’s oversight arrangements, in place during the investigation period, were compliant with Rule 8 of the IGR.

238. For the sake of clarity, we reiterate that the purpose of the investigation was to test whether TLS’s oversight and monitoring of the SRA was such that representative functions impaired the independence or effectiveness of the performance of the SRA’s regulatory functions, in breach of Rule 8 of the IGR. In particular we looked at the intended role and subsequent operation of:

- (a) the BOB
- (b) TLS's Council, the RemCo and the AC, but only to the extent they exercised TLS's oversight and monitoring of the SRA's performance of regulatory functions.

239. The relevant period for the investigation was autumn 2014 to 15 February 2017.

240. The relevant parts of the IGR was Rule 8, and Rules 2B and 4A of the Schedule.

#### *Rule 8 and the Schedule to the IGR*

241. Rule 8 obliges AARs, such as TLS, to have in place arrangements that meet the requirements of the Schedule to the IGR. In reviewing the evidence (see Sections 5, 6.1 and 6.2) we gathered against the Schedule, we identified the following:

- The SRA, as the regulatory body, was not responsible for designing the competency requirements and designing and managing the appointments and reappointments process for its own Board members. This is in breach of Rule 2B and therefore a breach of Principle 2(1) of the Schedule to the IGR.
- The oversight and monitoring arrangements were not proportionate or transparent. This in breach of Rule 4A of the Schedule to the IGR.
- The outcome of the oversight and monitoring arrangements was that the combination of multiple reporting demands and associated delay had a direct impact on the SRA's efficiency, and so impaired the SRA's effectiveness in performing its regulatory functions to some degree. This is therefore a breach of Principle 4 of the Schedule to the IGR in respect of the effectiveness of the SRA's performance of its regulatory functions.

#### *Rule 2B and Principle 2(1) of the Schedule to the IGR: Appointments*

242. The obligation in Rule 2B of the Schedule to the IGR requires TLS as AAR to ensure the SRA is responsible for designing and managing the appointment and reappointment process of SRA Board members. This obligation exists so that those processes are "demonstrably free of undue influence from persons with representative functions", as stated in Principle 2(1) of the Schedule.

243. In April 2014, we amended our IGR to move the responsibility for appointments and reappointments to the regulatory body. However, since that time TLS's General Regulations were not amended to reflect this rule change. Whilst we note that since April 2014, TLS delegated the appointments and reappointments process to a specially convened appointments panel managed by the SRA, the SRA still had to seek TLS's Council approval before beginning its



appointments and reappointments process. The failure of TLS to amend its General Regulations and processes to reflect the changes made to the IGR in April 2014 around appointments amounts to a breach of Rule 2B of the Schedule. We stress that we did not see evidence of any actual undue influence as a result of the failure to amend the General Regulations. The requirement in Principle 2 of the Schedule is strict: an AAR's arrangements must be demonstrably free of undue influence, whether or not any actual undue influence occurs.

244. Given all of the above, we conclude that there was a breach of Rule 2B and Principle 2(1) of the Schedule to the IGR.

*Rule 4A of the Schedule to the IGR: Proportionality and transparency*

245. TLS is the largest AR, authorising approximately ten times the number of individuals as the second largest AR. It has a number of entities consolidated within its group structure. Notwithstanding an inevitable degree of complexity, we conclude that the operation of its oversight arrangements during the relevant period were not transparent nor proportionate because:

- there was an overlap and ambiguity in the terms of reference for the oversight bodies resulting in:
  - duplicative reporting requirements on the SRA
  - a lack of clarity as to who was accountable for scrutiny of each aspect of the oversight of the SRA and the related decisions.
- the General Regulations:
  - were incomplete – they did not contain the reporting arrangements for the BOB to TLS Council, nor the assurances TLS offered us in relation to seeking the LSB's views before TLS Council ever used its powers around discipline and removal of SRA Board members
  - were out of date – they were not updated to reflect changes to the IGR in April 2014 nor changes to the work of the BOB following the closure of Corporate Solutions
  - there was a lack of shared understanding as to what each body in the oversight arrangements should do, see and discuss and how they linked with each other.

246. The arrangements in the relevant period when implemented did not ensure that the principles of good corporate governance were balanced with the requirements of the Act (e.g. TLS's residual role as an AR) in a proportionate way. Instead these obligations were fighting against each other in the arrangements (as explained in Section 6.1). This could have potentially been

improved if there had been tailored recruitment and induction processes which enabled the external members of the Boards and Committees to have a shared understanding of the oversight arrangements, if the aborted review of the effectiveness of the BOB had gone ahead, or if TLS had reviewed the processes and made progressive enhancements to the arrangements.

247. Given all of the above, we conclude that there was a breach of Rule 4A of the Schedule to the IGR.

*Principle 4 of the Schedule to the IGR: Oversight*

248. The outcome of the arrangements was that the combination of multiple reporting demands and associated delay had a direct impact on the SRA's efficiency, and so impaired the SRA's effectiveness in performing its regulatory functions to some degree (see Section 6.1). Whilst some of this was to be expected in a group structure and with the obligations under the Act (i.e. some information requests will be made and some degree of reporting will be necessary), this did not explain it all.

249. From our review of the evidence, it is unclear whether some of the reporting demands were necessary given their impact on the SRA's efficiency. Should the:

- SRA's strategic risk register have been considered by both the AC and the BOB?
- AC have received a business update in the form offered?
- The SRA Chair and Chief Executive both produce reports for the BOB?
- Various oversight bodies all have had a role in approving the draft and final budget and net funding requirement?

250. We also consider that TLS's Council's involvement in rule change applications and appointments and reappointments are examples where the SRA's effectiveness was impaired because TLS's Council's involvement built in additional layers of complexity to both processes and thereby created inefficiencies and a lack of transparency.

251. Whilst we did not find that the SRA's independence was impaired by the oversight arrangements, we identified in Section 6.2, that the General Regulations provided the potential for it to be impaired if the risks related to certain provisions were to crystallise (see paragraphs 200–207). There is scope to limit further these opportunities.

252. As we have found that the SRA's effectiveness was impaired, we conclude that there was a breach of Principle 4 of the Schedule to the IGR.

## Conclusions

253. In summary we consider that during the relevant period, the arrangements did not comply with Rules 2B and 4A, and Principles 2(1) and 4 of the Schedule to the IGR. Accordingly we find that Rule 8 was breached by TLS.

# Annex A: Internal Governance Rules 2009 (as amended)

Version 3: 30 April 2014

The Legal Services Board has, on 9 December 2009, made the following rules under Legal Services Act 2007 (c.29), section 30(1) – (as amended 20 February and 30 April 2014):

## A. DEFINITIONS

1. In these Rules, a reference to “the principle of regulatory independence” is a reference to the principle that:

**structures or persons with representative functions must not exert, or be permitted to exert, undue influence or control over the performance of regulatory functions, or any person(s) discharging those functions.**

2. The words defined in these Rules have the following meanings:

<b>Act</b>	the Legal Services Act 2007 (c.29)
<b>Applicable Approved Regulator</b>	an Approved Regulator that is responsible for the discharge of regulatory and representative functions in relation to legal activities in respect of persons whose primary reason to be regulated by that Approved Regulator is those person’s qualifications to practise a reserved legal activity that is regulated by that Approved Regulator
<b>Approved Regulator</b>	has the meaning given in Section 20(2) of the Act
<b>Board</b>	the Legal Services Board

<b>Consumer Panel</b>	the panel of persons established and maintained by the Board in accordance with Section 8 of the Act
<b>lay person</b>	has the meaning given in Schedule 1, paragraphs 2(4) and (5) of the Act
<b>legal activities</b>	has the meaning given by section 12(3) of the Act
<b>OLC</b>	the Office for Legal Complaints established under Section 114(1) of the Act
<b>person</b>	includes a body of persons (corporate or unincorporated)
<b>prejudice</b>	the result of undue influence, whether wilful or inadvertent, causing or likely to cause the compromise or constraint of independence or effectiveness
<b>regulatory board</b>	has the meaning given by Rule B in Part 1 of the Table in the Schedule to these Rules
<b>regulatory functions</b>	has the meaning given by Section 27(1) of the Act
<b>regulatory objectives</b>	has the meaning given by section 1(1) of the Act
<b>representative functions</b>	has the meaning given by Section 27(2) of the Act
<b>representative interests</b>	the interests of persons regulated by the Approved Regulator
<b>reserved legal activities</b>	has the meaning given by section 12(1) of the Act
<b>undue influence</b>	pressure exercised otherwise than in due proportion to the surrounding circumstances, including the relative strength and position of the parties involved, which has or is likely to have

a material effect on the discharge of a regulatory function or functions.

## **B. WHO DO THESE RULES APPLY TO?**

3. These Rules are the rules that the Board has made in compliance with 30(1) of the Act relating to the exercise of Approved Regulators' regulatory functions.
4. Accordingly, these Rules apply to each Approved Regulator.
5. In the event of any inconsistency between these Rules and the provisions of the Act, the provisions of the Act prevail.

## **C. GENERAL DUTY TO HAVE IN PLACE ARRANGEMENTS**

6. Each Approved Regulator must:
  - (a) have in place arrangements that observe and respect the principle of regulatory independence; and
  - (b) at all times act in a way which is compatible with the principle of regulatory independence and which it considers most appropriate for the purpose of meeting that principle.
7. Without limiting the generality or scope of Rule 6, the arrangements in place under that Rule must in particular ensure that:
  - (a) persons involved in the exercise of an Approved Regulator's regulatory functions are, in that capacity, able to make representations to, be consulted by and enter into communications with any person(s) including

but not limited to the Board, the Consumer Panel, the OLC and other Approved Regulators;

- (b) the exercise of regulatory functions is not prejudiced by any representative functions or interests;
- (c) the exercise of regulatory functions is, so far as reasonably practicable, independent of any representative functions;
- (d) the Approved Regulator takes such steps as are reasonably practicable to ensure that it provides such resources as are reasonably required for or in connection with the exercise of its regulatory functions; and
- (e) the Approved Regulator makes provision as is necessary to enable persons involved in the exercise of its regulatory functions to be able to notify the Board where they consider that their independence or effectiveness is being prejudiced.

#### **D. REQUIREMENTS FOR APPLICABLE APPROVED REGULATORS**

- 8. In the case of each Applicable Approved Regulator, the arrangements in place under Rule 6 must also meet the requirements set out in the Schedule to these Rules.

#### **E. ENSURING ONGOING COMPLIANCE**

- 9. Each Applicable Approved Regulator, jointly with its regulatory board, must:
  - (a) if it considers itself to be compliant with these Rules, certify such compliance in the form and manner prescribed by the Board from time to time; or
  - (b) if it considers itself not to be compliant with these Rules, in some or all respects, notify such non-compliance and set out:

- (i) why it has been unable to comply in such respects as it has identified;
- (ii) when it considers that it will be compliant; and
- (iii) how it plans to achieve compliance, and by when, and how much it is expected to cost.

10. Subject to the agreement of the Board, an Applicable Approved Regulator may invite any other appropriate body, including a consumer panel associated with the Applicable Approved Regulator, to provide a certification in a similar form and manner.

## **F. GUIDANCE**

11. Approved Regulators must, in seeking to comply with these Rules, have regard to any guidance issued by the Board under this Rule.

12. For the avoidance of doubt, any guidance issued under Rule 11 does not, of itself, constitute a part of these Rules.



## Schedule to Internal Governance Rules

The requirements set out in this Schedule are that Applicable Approved Regulators, in making arrangements under these Rules, must:

- (a) adhere to the principles set out in the table below in respect of specified areas which arrangements must cover;
- (b) comply with the rules set out in the table below in respect of demonstrating compliance with the principles; and
- (c) take account of the illustrative guidance set out in the table below when seeking to comply with the principles and rules.

Principle	Rule	Illustrative guidance
<p><b>Part 1: Governance</b></p> <p>Nothing in an Applicable Approved Regulator's (AAR's) arrangements should impair the independence or effectiveness of the performance of its regulatory functions.</p>	<p><b>A.</b> Each AAR must delegate responsibility for performing all regulatory functions to a body or bodies (whether or not a separate legal entity/separate legal entities) without any representative functions (herein after '<b>the regulatory body</b>' or '<b>the regulatory bodies</b>').</p>	<p>An AAR should take all reasonable steps to agree arrangements made under these Rules with the regulatory body or, as the case may be, the regulatory bodies.</p>
	<p><b>B.</b> The regulatory body or, if more than one, each of the regulatory bodies, must be governed by a board or</p>	<p>If an AAR wishes otherwise than through its regulatory body/bodies to offer guidance to its members or more widely on regulatory matters, it should:</p> <ul style="list-style-type: none"> <li>• ensure that it does not contradict or add material new requirements to any rules or guidance made by the regulatory body/bodies; and</li> <li>• consult with the regulatory body/bodies when developing that guidance.</li> </ul>

	equivalent structure (herein after the ' <b>regulatory board</b> ').	
	<p><b>C.</b> In appointing persons to regulatory boards, AARs must ensure that:</p> <ul style="list-style-type: none"> <li>• a majority of members of the regulatory board are lay persons; and</li> <li>• the chair of the regulatory board is a lay person</li> </ul>	
<p><b>Part 2: Appointments etc</b></p> <p>(1) Processes in place for regulatory board members' appointments, reappointments, appraisals and discipline must be demonstrably free of undue influence from persons with representative functions.</p>	<p><b>A.</b> All appointments to a regulatory board must be made on the basis of selection on merit following open and fair competition, with no element of election or nomination by any particular sector or interest groups.</p>	<p>Best practice for public appointments should be taken into account. In particular, account should be taken of the Code of the Commissioner of Public Appointments insofar as relevant. This includes publishing clear criteria for available roles and publishing details of the selection process<sup>24</sup>.</p>
		<p>The appointments panel should be – and should be seen to be – capable of producing a qualified and independent regulatory board. This is likely to mean having:</p> <ul style="list-style-type: none"> <li>• having at least one lay representative on the appointments panel or equivalent</li> <li>• having at least one representative external to the AAR and regulatory board on the appointments panel or equivalent</li> </ul>
	<p><b>B:</b> The regulatory body must be responsible for:</p>	<p>The regulatory board should strongly involve the AAR at all stages - fully</p>

<sup>24</sup> This should apply to roles on the appointment panel as well as roles on the regulatory board

<p>(2) All persons appointed to regulatory boards must respect the duty to comply with the requirements of the Legal Services Act 2007.</p>	<ul style="list-style-type: none"> <li>• designing competency requirements</li> <li>• designing and managing the appointments and reappointments process</li> </ul>	<p>consulting it on the key aspects of the <i>appointments and reappointments process</i>.</p> <p><i>A proper audit trail of the discussions, the points considered and final decisions made should be maintained.</i></p>
	<p><b>C.</b> The selection of persons so appointed must itself respect the principle of regulatory independence and the principles relating to “appointments etc” set out in this Part of this Schedule.</p>	<p>A representative of the AAR should always form part of the appointment panel or equivalent</p>
	<p><b>D.</b> Decisions in respect of the remuneration, appraisal, reappointment and discipline of persons appointed to regulatory boards must respect the principle of regulatory independence and the principles relating to “appointments etc” set out in this Part of this Schedule.</p>	<ul style="list-style-type: none"> <li>• Remuneration – decisions in respect of regulatory board pay and conditions should be made having regard to best practice and in any event should not be controlled wholly or mainly by persons responsible for representative functions;</li> <li>• Appraisals – while persons with representative functions may be consulted about regulatory board members’ appraisal, they should not be involved formally in agreeing the outcome, or future objectives;</li> </ul>
	<p>The process and decisions on appointments and reappointments of regulatory chairs should be delegated to an independent appointment panel or equivalent</p>	<p>The appointments process should be conducted with regard to the desirability of securing a diverse board with a broad range of skills. The framework applied at Schedule 1 paragraph 3 of the Act serves as a useful template.</p>

		<ul style="list-style-type: none"> <li>• Reappointments – decisions should be guided by objective appraisals and the desirability of ensuring a balance between regular turnover <u>and</u> continuity.</li> </ul>
	<p><b>E.</b> Except insofar as an AAR would be, or would reasonably be considered likely to be, exposed to any material legal liability (other than to pay wages, salaries etc) as a consequence of the delay required to obtain the concurrence of the Board, no person appointed to a regulatory board must be dismissed except with the concurrence of the Board.</p>	<p>While the LSB accepts that there may be <u>exceptional</u> reasons which justify immediate dismissal without concurrence having first been obtained, it would expect a full explanation if such circumstances were ever to arise. An AAR should accordingly be prepared to justify why it could not comply with the relevant Rule.</p> <p>Where an AAR proposes to discipline one or more member(s) of a regulatory board, where such discipline is short of dismissal, the Board should be consulted privately in advance of the action being taken, and the AAR should consider any representations the Board may choose to make.</p>
	<p><b>F.</b> No person appointed to and serving on a regulatory board must also be responsible for any representative function(s).</p>	<p>Where possible, a person appointed should not have been responsible for any representative functions immediately prior to appointment. The longer the gap between holding responsibility for representative functions and taking up regulatory functions, the more likely it is that the principle of regulatory independence will be observed.</p> <p>Codes of conduct or equivalent for board members should highlight the importance of observing and respecting the regulatory objectives and the principles of better regulation, rather than operating to represent any one or more sectoral interests.</p>

		Codes should also highlight the importance of respecting the principle of regulatory independence, as underlined by the provisions of sections 29 and 30 of the Act.
<p><b>Part 3: Strategy and Resources etc</b></p> <p>Subject only to the oversight permitted under Part 4 of this Schedule, persons performing regulatory functions must have the freedom to define a strategy for the performance of those functions and work to implement that strategy independently of representative control or undue influence.</p>	<p><b>A.</b> Defining and implementing a strategy should include:</p> <ul style="list-style-type: none"> <li>• access to the financial and other resources reasonably required to meet the strategy it has adopted;</li> <li>• effective control over the management of those resources; and</li> <li>• the freedom to govern all internal processes and procedures.</li> </ul>	<p>The Act requires separation of regulatory and representative functions. Absent of corporate management structures that are robustly and demonstrably separated from the control of persons with representative functions, these Rules are likely to require a high degree of delegation to regulatory bodies in respect of the control of strategy and resourcing.</p> <p>What is or is not a regulatory function is determined in accordance with the Act. Subject to the Act, whether something is 'regulatory' should be for each regulatory body to determine, in close consultation with respective AARs.</p>

		<p>Where members of staff are employed by an AAR to discharge regulatory functions under the delegated remit of a regulatory body, the position of the AAR as legal employer should be recognised in the arrangements made under these rules. However, in complying with these Rules, those arrangements should make clear how decisions with respect to the management and control of such members of staff are to be exercised. The presumption under such arrangements should be – subject only to being exposed to unreasonable liability (such as in creating a pension scheme) – that an AAR should always agree a reasonable request from its regulatory body. While an AAR has a right of veto, therefore, it also carries a responsibility to justify that decision in light of the principle of regulatory independence.</p> <p>The Board may from time to time issue further illustrative guidance on these issues under Rule 11 of these Rules.</p>
		<p>Each regulatory body should act reasonably when defining and implementing its strategy, and should in particular have regard to the provisions of Section 28 of the Act. It should also have due regard to the position of the AAR and in particular to any responsibilities or liabilities it may have as AAR.</p>
	<p><b>B.</b> The regulatory body (or each of the regulatory bodies) must have the power to do anything within its allocated budget calculated to facilitate, or</p>	<p>Each regulatory body should act reasonably when exercising its functions in accordance with this Rule, and should in particular have regard to the provisions of Section 28 of the Act.</p>

	<p>incidental or conducive to, the carrying out of its functions.</p>	<p>It should also have due regard to the position of the AAR and in particular to any responsibilities or liabilities it may have as AAR.</p>
	<p><b>C.</b> Insofar as provision of resources is concerned, arrangements must provide for transparent and fair budget approval mechanisms.</p>	<p>The process established by the AAR should provide appropriate checks and balances between it and the regulatory body (or bodies) so as to ensure value for money and observe the wider requirements of the Act, without impairing the independence or effectiveness of the regulatory body (or bodies).</p>
	<p><b>D.</b> Insofar as provision of any non-financial resources is concerned (for example, services from a common corporate service provider, or staff), arrangements must provide for transparent and fair dispute resolution mechanisms.</p>	<p>Subject only to the formal budgetary approval process and the operation of its dispute resolution mechanism(s) , an AAR's arrangements should not prevent those performing regulatory functions, where they believe their independence and/or effectiveness is compromised or prejudiced, from obtaining required services otherwise than through the AAR.</p> <p>AARs and regulatory bodies should be particularly careful to ensure that, in respect of public and/or consumer-facing services (including media relations and marketing-type activities), the principle of regulatory independence should be seen to be met, as well as being met.</p> <p>When considering whether arrangements meet the required standards, the Board will consider factors such as:</p> <ul style="list-style-type: none"> <li>• evidence that the provision of services to the regulatory body (or bodies) is not subordinate to the provision of services to any other part of the AAR;</li> </ul>

		<ul style="list-style-type: none"> <li>• provision being made for service level agreements agreed between respective parties; and</li> <li>• transparent, fair and effective dispute resolution mechanisms being in place.</li> </ul>
<b>Part 4: Oversight etc</b>  Oversight and monitoring by the AAR (which is ultimately responsible and accountable for the discharge of its regulatory functions) of persons performing its regulatory functions must not impair the independence or effectiveness of the performance of those functions.	<b>A.</b> Arrangements in place must be transparent and proportionate.	In making its arrangements, an AAR should balance its ultimate responsibility for the discharge of regulatory functions with its responsibilities to ensure separation of regulatory and representative functions.
		In considering proportionality, AARs should consider the risk of Board intervention. Note the Board’s policy statement on compliance and enforcement powers, and in particular the Board’s intention to use its most interventionist powers only when other measures (including informal measures) have failed.
	<b>B.</b> Arrangements in place must prohibit intervention, or the making of directions, in respect of the management or performance of regulatory functions unless with the concurrence of the Board.	In determining whether to give concurrence, the Board will consider the extent to which the process leading to the proposed intervention or directions complies with the principle of regulatory independence.



## Annex B: The establishment of the BOB (2011)

- B1. In our March 2009 consultation document (paragraphs 3.34–3.38) on the IGR we suggested ‘that the management and discharge of any supervisory functions might, in practice, sit best with a body that is itself demonstrably independent of representational control.’<sup>25</sup> The body established to oversee the provision of (and resolve disputes about) shared services could be charged with undertaking any routine and agreed monitoring activities, for example. The representative-controlled body could then be kept informed, but at the same time it would be insulated from criticism concerning the extent to which it holds – or is seen to hold – levers of power or control over the discharge of regulatory functions.’
- B2. Following the establishment of our IGR, we carried out dual self-certification exercises annually between 2010 and 2013. For the 2011 exercise which we carried out to assess the regulators’ compliance with our IGR, TLS and the SRA were asked to submit separate documentation certifying their compliance with the IGR and describing how this was being achieved. Upon receipt of these submissions it became clear that there were significant differences in opinion as to how the arrangements were operating. Additionally, in its response the SRA made a number of allegations about practices which, if substantiated, would have been a breach of the rules. Following our review and consideration of this documentation, we asked TLS and the SRA to work together to agree new arrangements which would comply with the IGR and reduce the potential of TLS fettering the independence of the SRA. The BOB and the associated reporting requirements was the outcome of this collaborative work.
- B3. The LSB carried out monitoring of the establishment and operation of the BOB between February 2012 and January 2014 using statutory information requests.<sup>26</sup> During this period we raised a number of issues because we remained concerned that in practice the design and role of the BOB was more complex, and that was evidenced by a lack of clarity about whom individuals were accountable to and how separate parts of the group were held to account; and the apparent blurring of oversight and executive decisions. We also said that the BOB should have independent and appropriate support to carry out its functions. We revoked the s55 notice monitoring of the BOB in January 2014. TLS committed to continuing to provide agendas and minutes to LSB on a voluntary basis.
- B4. From October 2014, the SRA raised concerns with us occasionally about the effectiveness of the BOB and the actions of TLS with the concerns being more persistently raised from 2016 onwards. This coincided with the outcome of the review of Corporate Solutions being implemented, the joint IT transformation programme beginning, and the SRA establishing its own Finance and Audit Committee and People Strategy Committee.

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<sup>25</sup> [http://www.legalservicesboard.org.uk/what\\_we\\_do/consultations/2009/pdf/regulatory\\_independence.pdf](http://www.legalservicesboard.org.uk/what_we_do/consultations/2009/pdf/regulatory_independence.pdf)

<sup>26</sup> See section 55 of the Act

## Annex C: Documentation reviewed and people we met with

C1. We list below the information that we reviewed as part of this investigation and who we met with.

C2. We reviewed:

### *Submissions from TLS and SRA*

- TLS submissions of November 2016 and January 2017
- SRA submissions of September 2016 and January 2017
- all correspondence received from TLS and SRA since the instigation of the investigation.

### *Internal documentation review*

- all internal documentation related to TLS/SRA IGR self-certification processes for 2011, 2012 and 2013 including Board papers
- all SRA and TLS internal meeting briefings and read-outs
- all SRA and TLS correspondence for relevant matters
- all senior management team meeting minutes
- all internal risk registers for relevant matters
- all regulatory standards documentation.

### *Documentation requested from TLS*

- all BOB meeting agendas, papers, minutes and reports to TLS's Council during the investigation period
- all RemCo meeting agendas, papers, minutes and reports to TLS's Council which related to TLS's oversight and monitoring of the SRA's performance of regulatory functions during the investigation period
- all AC meetings papers, minutes and reports to TLS's Council which related to TLS's oversight and monitoring of the SRA's performance of regulatory functions during the investigation period
- all TLS's Council meetings papers and minutes which related to TLS's oversight and monitoring of the SRA's performance of regulatory functions during the investigation period
- all terms of reference used by the BOB, the AC and the RemCo during the investigation period

- the terms of review for the aborted BOB effectiveness review
- the terms of appointment, induction and advertising material used for all relevant external BOB members and AC members
- TLS General Regulations dated October 2014 and July 2015
- Sheila Spicer's report on options for regulatory and representative separation
- the rulemaking protocol
- the role of approved regulator report produced by TLS and the SRA
- correspondence shared between the Chair of the SRA Board and the Chair of the BOB in February and May 2015 and the Chair of the RemCo in summer 2016.

*Other documentation*

- good practice guidance on corporate governance such as the FRC's UK Code of Corporate Governance (April 2016) and ICSA guidance on Audit Committees and Remuneration Committees.

C3. We met with:

- Bob Spedding (former Chair of TLS Audit Committee, 1 January 2010–31 December 2015)
- Brenda Dean, Baroness Dean of Thornton-le-Fylde (Member of the Business and Oversight Board and current Chair of the Remuneration Committee, October 2015–March 2018)
- David Fisher (first Chair of the Business and Oversight Board and Remuneration Committee, 1 February 2012–31 August 2015)
- Gautam Dalal (current Chair of TLS Audit Committee, 1 January 2016–December 2017)
- John Heaps (Member of the Business and Oversight Board and the Remuneration Committee, 2014–present)
- Michael Blacker (second Chair of the Business and Oversight Board and the Remuneration Committee, 2012–2016)
- Paul Philip, Chief Executive (SRA)
- Richard Collins, Executive Director, Strategy and Resources (SRA)

## Annex D: Terms of reference and membership

### Business and Oversight Board

- D1. The establishment of the BOB and its terms of reference were jointly developed and agreed by TLS and the SRA in 2011. The BOB carries out similar management and corporate functions to TLS Management Board but in the main solely for the SRA. Its terms of reference are set out in TLS General Regulations 39–41.
- D2. The BOB has responsibility for:
- recommending to TLS’s Council the budget for the SRA and dealing with all matters of budgetary control within the SRA
  - on recommendation from the Remuneration Committee, deciding on the remuneration and terms and conditions of the Chair and members of the SRA Board, reporting to TLS’s Council if it does not follow those recommendations
  - exercising oversight of the SRA in accordance with the requirements of Council, including scrutiny of the business plan, monitoring performance and scrutiny of the strategic risk register
  - forming a sub-committee to advise TLS’s Council directly on policy issues concerning the appointment of the Chair and members of the SRA Board (although this ceased occurring in 2014)
  - keeping under review the arrangements agreed between TLS in its AR capacity and the SRA for oversight of the latter's functions
  - Dealing with all matters relating to the provision of shared support services to the SRA and TLS including IT, finance, management information and programme management, risk management, premises and facilities management and human resources
  - Advising TLS’s Council on the budget for Shared Services.
- D3. The Chair of the AC can attend the BOB to discuss the annual audit reports and financial statements. The AC should also let the BOB know about any outstanding matters from external audits and any areas of concern from internal audits.
- D4. The General Regulations also set out that a member who is a TLS Council and BOB member may propose a motion to request the SRA Board to consider an issue exclusively within the SRA Board’s terms of reference.
- D5. The BOB is comprised of

- three external members, appointed by the President of TLS and the SRA Chair. According to the General Regulations, one of the three external members of the BOB will be elected as Chair
- four members from TLS: the President, Treasurer, a Council member, and the Chief Executive
- four members from the SRA: the Chair, Chief Executive, a Board member and the SRA member who also sits as the Finance and Audit Committee Chair (this was previously the Finance and Resources Committee).

### **Audit Committee**

D6. The AC's terms of reference are set out in regulations 43–44 of the General Regulations. Its powers are to:

- assist and advise the MB and TLS's Council in ensuring accounts and final statements are true and fair and in conformity with the applicable accounting standards
- advise the MB on appointment of external auditors and to oversee their and related work (including any action to be taken in light of the auditor's management letter), independence and value for money
- receive and consider reports from staff engaged in the internal audit function, reporting to the MB, BOB and TLS's Council on concerns arising from such reports or relating to the financial control environment and risk management
- keep under review arrangements for internal audit, internal control and risk management, reporting to the MB and TLS's Council on any concerns related to resources, independence or any matters effecting the effectiveness of these functions
- keep under review compliance with the Code on Corporate Governance and guidance on internal control and to advise the MB and TLS's Council on corporate governance issues
- advise the MB and TLS's Council on all aspects of audit and financial control within TLS.

D7. The AC has information gathering powers in its terms of reference. It may require any relevant paper from any TLS or the SRA Board, Board member or member of staff and require any member of staff to attend a Committee meeting to provide information. Any failure to comply is referred for possible disciplinary action. It may also seek external advice on any aspect of its terms of reference.

D8. The AC may also report to the SRA Board and the BOB on any aspects of the Committee's terms of reference which it sees as relevant to the SRA Board.

D9. The AC is comprised of 8 members. These are

- an external Chair
- one TLS Council member
- one SRA Board member
- one solicitor who is not a Council member
- four external members.

D10. The AC generally meets five times a year.

### **Remuneration Committee**

D11. The RemCo advises TLS Council on pay policy and terms and conditions for all employees in TLS. The RemCo terms of reference are set out in TLS's General Regulations 51–52. Its role in overseeing the SRA is threefold.

D12. It makes recommendations to the SRA Board on:

- the performance management framework for the SRA CEO, the senior managers reporting directly to him and the senior managers reporting directly to them
- the pay policy, terms, conditions and incentive arrangements of the SRA CEO
- proposed bonus and incentive payments to the SRA CEO and whether the underlying process is reasonable
- any non-contractual severance payments for the SRA CEO, senior managers reporting directly to him and senior managers reporting directly to them
- pay policy and conditions of employment of senior managers reporting directly to the SRA CEO and the senior managers reporting directly to them and on the policy and processes by which their bonuses and incentive payments are determined.

D13. It makes recommendations to the BOB after, consultation with TLS, on remuneration and terms and conditions of the SRA Board Chair.

D14. It makes recommendations to the Chair of the SRA Board on the remuneration and terms and conditions of SRA Board members.

D15. There are five members of the RemCo. Three members, including the Chair, are the external members of the BOB. Only the external members have voting

rights. The remaining two are non-voting members: the Treasurer of TLS and a member of the SRA Board.

D16. The function of the RemCo is to advise and recommend, rather than to decide. If there are disagreements amongst the members the expectation is that they will be discussed and resolved. In the event of a disagreement, the three external members would vote on it.

## Annex E: Timeline of meetings and oversight activity during relevant period

Date	Meeting	Oversight activity
September 2014		
10 Sep	AC	<ul style="list-style-type: none"> <li>• TLS annual report</li> <li>• SRA update</li> <li>• Internal audit progress report</li> </ul>
October 2014		
3 Oct	BOB	<ul style="list-style-type: none"> <li>• <b>First independent Chair of BOB in place (from 1 February 2012 to 31 August 2015)</b></li> <li>• Delegated financial authorities proposal</li> <li>• SRA Chair and CEO reports</li> <li>• RemCo recommendations for SRA Board members</li> <li>• SRA Budget 2015</li> </ul>
14 Oct	Council	<ul style="list-style-type: none"> <li>• BOB report to Council</li> <li>• Internal control framework (from Corporate Solutions)</li> </ul>
November 2014		
11 Nov	BOB	<ul style="list-style-type: none"> <li>• Corporate Solutions monitoring report</li> <li>• SRA Chair and CEO reports</li> <li>• SRA risk register</li> <li>• Group risk register</li> </ul>
10 Nov	RemCo	<ul style="list-style-type: none"> <li>• SRA Board remuneration paper</li> <li>• Reward principles</li> <li>• TLS group reward and recognition project</li> </ul>
December 2014		
2 Dec	AC	<ul style="list-style-type: none"> <li>• SRA corporate strategy, business plan and diversity and inclusion strategy</li> <li>• Group internal audit progress report</li> </ul>
10 Dec	Council	<ul style="list-style-type: none"> <li>• BOB report to Council</li> <li>• SRA annual report 2013/14</li> <li>• Group internal control framework</li> </ul>
February 2015		
5 Feb	RemCo	<ul style="list-style-type: none"> <li>• Pay papers</li> <li>• SRA CEO's performance review</li> <li>• SRA Executive Directors' performance reviews</li> <li>• Vice Chair of SRA</li> </ul>
6 Feb	BOB	<ul style="list-style-type: none"> <li>• Corporate Solutions monitoring report</li> <li>• SRA Chair and CEO reports</li> <li>• RemCo recommendation on the remuneration for a proposed Vice Chair of the SRA Board</li> </ul>



		<ul style="list-style-type: none"> <li>• RemCo's recommendation on pay and bonus for Corporate Solutions executives</li> </ul>
11 Feb	Council	<ul style="list-style-type: none"> <li>• BOB report to Council</li> <li>• Internal control framework</li> <li>• Interim audit report</li> </ul>
18 Feb	AC	<ul style="list-style-type: none"> <li>• Internal audit progress report</li> <li>• SRA update</li> </ul>
March 2015		
23 Mar	AC	<ul style="list-style-type: none"> <li>• SRA CEO update</li> <li>• Group internal audit assurance report 2015</li> </ul>
25 Mar	Council	<ul style="list-style-type: none"> <li>• Martin Lane lease</li> <li>• Internal control framework</li> </ul>
31 Mar	RemCo	<ul style="list-style-type: none"> <li>• Alignment of pay and bonus period to new financial year</li> <li>• AC Chair day rate</li> <li>• Annual pay and bonus recommendation template report</li> </ul>
April 2015		
1 Apr	BOB	<ul style="list-style-type: none"> <li>• Net Funding Requirement process</li> <li>• Corporate Solutions monitoring report</li> <li>• SRA Chair and CEO reports</li> <li>• SRA KPI report</li> <li>• Assigned risk pool provision policy (frequency and basis of actuarial valuation)</li> <li>• HR Strategy</li> </ul>
May 2015		
20 May	Council	<ul style="list-style-type: none"> <li>• BOB report to Council</li> <li>• Internal control framework</li> <li>• RemCo annual report to Council</li> </ul>
June 2015		
15 Jun	RemCo	<ul style="list-style-type: none"> <li>• Alignment of executive pay and performance cycle with financial year</li> <li>• Annual pay and bonus template</li> <li>• Role of REMCO in special situations (exit and settlement agreements)</li> </ul>
16 Jun	BOB	<ul style="list-style-type: none"> <li>• Corporate Solutions Net Funding Requirement</li> <li>• Corporate Solutions Review</li> <li>• SRA Net Funding requirement and budget</li> <li>• Renewal for Martin Lane lease</li> <li>• SRA Chair and CEO reports</li> </ul>
24 Jun	AC	<ul style="list-style-type: none"> <li>• SRA CEO update</li> <li>• Internal audit progress report</li> <li>• Group risk forum</li> </ul>

July 2015		
8–9 Jul	Council	<ul style="list-style-type: none"> <li>• BOB report to Council</li> <li>• Facilities outsourcing</li> <li>• Internal control framework</li> <li>• Net funding requirement, Practising Certificate Fee and compensation fund levy 2016</li> <li>• Audit Committee annual report 2014</li> </ul>
September 2015		
15 Sep	RemCo	<ul style="list-style-type: none"> <li>• Remuneration of AC Chair</li> <li>• Benchmarking of executive remuneration</li> <li>• Template for next round of pay and bonus recommendations</li> <li>• Alignment of pay and performance and financial year.</li> </ul>
16 Sep	BOB	<ul style="list-style-type: none"> <li>• <b>TLS/SRA joint chairs</b></li> <li>• Adoption of the Financial Reporting Standard 102</li> <li>• SRA Chair and CEO reports</li> <li>• IT Review</li> <li>• Corporate Solutions review update</li> </ul>
22 Sep	Council	<ul style="list-style-type: none"> <li>• Internal control framework</li> <li>• AX update</li> </ul>
23 Sep	AC	<ul style="list-style-type: none"> <li>• SRA CEO update</li> <li>• Corporate Solutions paper</li> <li>• Internal audit and group risk progress report</li> </ul>
October 2015		
16 Oct	BOB	<ul style="list-style-type: none"> <li>• <b>TLS/SRA joint chairs</b></li> <li>• BD started as an external member</li> <li>• 2015/16 SRA budget</li> <li>• Corporate Solutions Review and recommendations</li> <li>• Corporate Solutions performance</li> <li>• Strategic risk registers for TLS, SRA and CS</li> <li>• SRA Chair and CEO reports</li> <li>• Corporate Solutions budget</li> <li>• Adoption of FRS 102</li> </ul>
28 Oct	Council	<ul style="list-style-type: none"> <li>• BOB report to Council</li> <li>• Corporate Solutions review</li> </ul>
November 2015		
20 Nov	BOB	<ul style="list-style-type: none"> <li>• <b>TLS/SRA joint chairs</b></li> <li>• SRA Chair report</li> <li>• SRA CEO report</li> <li>• Shared Services report</li> </ul>
December 2015		

2 Dec	AC	<ul style="list-style-type: none"> <li>• SRA CEO update</li> <li>• Internal audit progress report</li> </ul>
9 Dec	Council	<ul style="list-style-type: none"> <li>• BOB report to Council (by TLS)</li> </ul>
January 2016		
1 Jan	AC	<ul style="list-style-type: none"> <li>• New chair of Audit Committee in post</li> </ul>
February 2016		
10 Feb	Council	<ul style="list-style-type: none"> <li>• SRA Annual report 2014/15</li> </ul>
11 Feb	AC	<ul style="list-style-type: none"> <li>• SRA CEO update</li> <li>• Internal control and AX improvements</li> <li>• SRA strategic risk register</li> </ul>
26 Feb	RemCo	<ul style="list-style-type: none"> <li>• Pay and bonus reports</li> <li>• Pensions report</li> <li>• Annual salary and bonus process and awards</li> </ul>
March 2016		
10 Mar	BOB	<ul style="list-style-type: none"> <li>• <b>Second independent Chair elected (from March 2016 to November 2016)</b></li> <li>• New Chair of RemCo elected</li> <li>• Shared Services report</li> <li>• SRA Chair and CEO reports</li> <li>• Approved Regulator paper</li> </ul>
23 Mar	AC	<ul style="list-style-type: none"> <li>• SRA CEO update</li> <li>• TLS annual report</li> <li>• Internal audit report</li> </ul>
30 Mar	Council	<ul style="list-style-type: none"> <li>• BOB report to Council (presented by TLS)</li> </ul>
April 2016		
7 Apr	BOB	<ul style="list-style-type: none"> <li>• IT Project</li> <li>• SRA Chair and CEO reports</li> <li>• Shared Services report</li> </ul>
May 2016		
18 May	Council	<ul style="list-style-type: none"> <li>• BOB report to Council</li> </ul>
June 2016		
9 Jun	AC	<ul style="list-style-type: none"> <li>• IT Roadmap (from minutes, not papers)</li> <li>• SRA CEO update</li> <li>• Internal audit progress report</li> <li>• SRA risk and business continuity update</li> <li>• SRA strategic risk register</li> <li>• Shared Services report</li> </ul>
15 Jun	RemCo	<ul style="list-style-type: none"> <li>• TLS Group Pay and Bonus review process: closing report 2015/16</li> <li>• Overview of objectives: CEOs and Executive Directors</li> </ul>
16 Jun	BOB	<ul style="list-style-type: none"> <li>• SRA Chair and CEO reports</li> </ul>

		<ul style="list-style-type: none"> <li>• Shared Services report</li> <li>• Shared Services Net Funding Requirement</li> <li>• SRA draft budget 16/17</li> <li>• IT transformation update</li> </ul>
July 2016		
13–14 Jul	Council	<ul style="list-style-type: none"> <li>• BOB report to Council</li> <li>• Net Funding Requirement, Practising Certificate Fee, Compensation levy 2016/17</li> <li>• Audit Committee annual report</li> <li>• IT roadmap</li> <li>• SRA annual report to TLS Council 2015/16.</li> </ul>
September 2016		
20 Sep	AC	<ul style="list-style-type: none"> <li>• SRA CEO report</li> <li>• SRA risk and business continuity update</li> <li>• SRA strategic risk register</li> <li>• Internal audit report (from external provider)</li> <li>• Shared Services update, including IT project</li> </ul>
29 Sep	BOB	<ul style="list-style-type: none"> <li>• SRA Chair and CEO reports</li> <li>• Shared Services report</li> </ul>
October 2016		
19 Oct	Council	<ul style="list-style-type: none"> <li>• BOB report to Council</li> <li>• RemCo annual report to Council</li> </ul>
November 2016		
24 Nov	BOB	<ul style="list-style-type: none"> <li>• SRA Chair and CEO reports</li> <li>• SRA budget 2016/17</li> <li>• Shared Services report</li> </ul>
December 2016		
2 Dec	AC	<ul style="list-style-type: none"> <li>• SRA CEO update</li> <li>• Shared Services update</li> <li>• Internal audit report</li> <li>• TLS &amp; SRA: IT business transformation</li> </ul>
14 Dec	Council	<ul style="list-style-type: none"> <li>• BOB report to Council</li> <li>• SRA budget 2016/17</li> </ul>
15 Dec	RemCo	<ul style="list-style-type: none"> <li>• Pay and bonus recommendations</li> <li>• Discussion on executive objectives</li> <li>• SRA Executive objectives: process for setting and reviewing them</li> </ul>
February 2017		
8 Feb	Council	<ul style="list-style-type: none"> <li>• <b>TLS/SRA joint chairs</b></li> <li>• Catering contract</li> </ul>

## Annex F: UK Corporate Governance Code

### Effectiveness

F1. The Financial Reporting Council's UK Corporate Governance Code (2016) (the Code) sets out that<sup>27</sup>:

- The search for board candidates should be conducted, and appointments made, on merit, against objective criteria and with due regard for the benefits of diversity on the board, including gender.
- The board should satisfy itself that plans are in place for orderly succession for appointments to the board.
- All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge.
- The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties.

In the preface it also sets out that it is essential to the effective functioning of any board that there is dialogue which is both constructive and challenging.

### Audit Committees

F2. The Code sets out that:

- The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting, risk management, internal control principles and for maintaining an appropriate relationship with the company's auditors.
- The board should establish an audit committee of at least three non-executive directors... The board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience. The audit committee as a whole shall have competence relevant to the sector in which the company operates.
- The main role and responsibilities of the audit committee should be set out in written terms of reference. The terms of reference of the audit committee, including its role and the authority delegated to it by the board, should be made available and should include:
  - monitoring the integrity of the financial statements of the company and any formal announcements relating to the company's financial

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<sup>27</sup> <https://www.frc.org.uk/getattachment/ca7e94c4-b9a9-49e2-a824-ad76a322873c/UK-Corporate-Governance-Code-April-2016.pdf>

performance, reviewing significant financial reporting judgements contained in them

- reviewing the company's internal financial controls and, unless expressly addressed by a separate board risk committee composed of independent directors, or by the board itself, to review the company's internal control and risk management systems
- monitoring and reviewing the effectiveness of the company's internal audit function
- making recommendations to the board in relation to the appointment, re-appointment and removal of the external auditor, approving the remuneration and terms of engagement of the external auditor
- reviewing and monitoring the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements
- developing and implementing policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm; and to report to the board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken
- report to the board on how it has discharged its responsibilities.
- Where requested by the board, the Audit Committee should provide advice on whether the annual report and accounts taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy.
- The Audit Committee should ensure that appropriate whistleblowing arrangements are in place for the organisation.
- The Audit Committee should monitor and review the effectiveness of the internal audit activities.

### **Remuneration Committees**

F3.The Code sets out that:

- The board should establish a Remuneration Committee ...which should make available its terms of reference, explaining its role and the authority delegated to it by the board (D.2.1.)

- The Remuneration Committee should have delegated responsibility for setting remuneration for all executive directors and the chairman, including pension rights and any compensation payments (D.2.2.).
- The Remuneration Committee should also recommend and monitor the level and structure of remuneration for senior management. The definition of 'senior management' for this purpose should be determined by the board but should normally include the first layer of management below board level (D.2.2.).