Freshfields Bruckhaus Deringer

LONDON
65 Fleet Street
London EC4Y 1HS
T +44 20 7936 4000
Direct T +44 20 7832 7059
F +44 20 7832 7001
Direct F +44 20 7108 7059
LDE No 23
E paul.lomas@freshfields.com
W freshfields.com

DOC ID LON22139912
OUR REF NPL/AJ
YOUR REF
CLIENT MATTER NO. PER-058226

Anna Colban
Financial Reporting Council
5th Floor, Aldwych House
71-91 Aldwych
London
WC2B 4HN

By Post & Email

19 September 2012

Dear Sirs

Response to the Financial Reporting Council's Consultation Paper: Disciplinary Schemes Proposed Changes (June 2012)

We have reviewed the Financial Reporting Council's Consultation Paper, 'Disciplinary Schemes Proposed Changes' (the ***Consultation Paper***) and the appended proposed amendments to the Schemes. We regularly act for clients that are regulated by the FRC and, as such, will be directly affected by the proposed amendments. While we are not submitting this response on behalf of any particular client, we seek in this response to highlight particular issues, both positive and negative, that are likely to be of particular interest and/or concern to our clients.

We set out below our responses to the specific questions raised in the Consultation Paper. However, by way of preliminary comment, we agree with the FRC's commitment to upholding the principles of fairness, transparency and proportionality in its disciplinary arrangements, and believe that those arrangements should seek to achieve regulatory best practice (in particular in relation to scoping the issues that are the subject of any investigation and containing the costs of the investigation for all concerned). We also agree that the disciplinary arrangements should be, and should be seen to be, independent of the professions concerned. This extends not just to professional bodies falling within the FRC's regulatory remit, but to professional services firms more generally. Accordingly, to the

extent that the proposed amendments uphold and further these principles, we are broadly supportive of them.

There are, however, a number of instances where we consider that the proposed amendments may not meet the FRC's stated objectives, and in our view require amendment, clarification or reconsideration. Since one of the primary objectives of a consultation process must be to identify such areas, we welcome the opportunity to participate in this consultation.

1. Should the Schemes be amended as set out in paragraphs 3.3 to 3.11 so as to enhance the independence of the disciplinary arrangements?

We note the removal of the need to agree a protocol with professional bodies in respect of preliminary enquiries. To the extent that the wider use of preliminary enquiries results in a more informed decision being taken as to whether to launch an investigation (and therefore obviously unmeritorious investigations not being launched – and publicised – at all) then we would welcome that. However, we would hope that the scope of any such preliminary enquiries would be tightly defined, without necessitating (for example) an extensive disclosure process on the part of the Member or Member Firm that is the subject of the enquiry. In other words, a preliminary enquiry should not be an investigation by another name.

The proposed amendments to the Accountancy Scheme provide, at paragraph 3(1)(v), that the Conduct Committee may delegate to the Chairman its powers to vary the scope of an investigation. The circumstances in which the Conduct Committee may make this delegation are not specified in the Scheme and it is unclear the extent to which there would be any oversight by the Conduct Committee where it has delegated its powers and (therefore) what level of accountability the Chairman would have for decisions made in the exercise of these powers. We also note that, if the Conduct Committee delegates its powers in this regard, the Chairman would be solely responsible for the decision as to whether to publicise a decision to extend the scope of an investigation to include a further Member or Member Firm.

In the absence of an explanation of why this power of delegation is being introduced, or clear guidelines as to how it will be exercised and controlled, we consider that this could result in too great a concentration of power in one individual. This also seems at odds with

the introduction, elsewhere in the amended Scheme, of the Case Management Committee and the mechanism for approving settlements, which seem geared (at least in part) towards sharing responsibility and improving accountability.

2. Are the proposals to conclude cases without the need for a tribunal hearing appropriate (paragraphs 3.12 to 3.13)?

It is clearly appropriate that there should be a mechanism for concluding cases without the need for a tribunal hearing, and the proposals set out in the revised Scheme seem broadly sensible in this regard.

We note that the proposed settlement process would only be available up to the point of delivery of a Formal Complaint, and thereafter any settlement would need the approval of the tribunal. This does not appear to be addressed in the Scheme itself, and it is not clear why the approval of the tribunal (as opposed to some other responsible body within the FRC) should be required. While we recognise that, for example, the SFO requires the sanction of the Court to enter into a settlement agreement, that is, of course, in the criminal context. A better comparator would be the FSA, in which its executive body is empowered to settle cases at any time prior to the issuance of a final notice, without the need for further approval by the relevant tribunal. Such an approach should deliver a more efficient conclusion to proceedings in appropriate cases.

A further point that should be clarified is the "without prejudice" status of any settlement discussions conducted by the Executive Counsel, such that the content of those discussions cannot subsequently be relied upon (by either party) in the event that no settlement is ultimately reached. Expressly removing any risk that any admissions made as part of settlement discussions could be used against the Member or Member Firm would encourage a greater degree of openness in the process which should, in turn, lead to more fruitful discussions and ultimately a greater number of settlements in appropriate cases. This would be consistent with the underlying objective of the settlement mechanism, to save time and costs where possible to do so.

3. Do you agree with the role envisaged for the Case Management Committee (paragraph 3.15)?

We agree that the introduction of a Case Management Committee is a sensible step insofar as it will assist the Executive Counsel in the conduct of his role. However, we believe that the proposals could go further. For example, in the context of the decision to deliver a Formal Complaint, the Consultation Paper explains that the Executive Counsel will present the case to the CMC for review, and the role of the CMC is "*to provide input and challenge to the Executive Counsel when reaching a decision on the adequacy of the evidence*." While at one level this role is to be welcomed, the fact remains that it is the Executive Counsel alone that decides whether to deliver a Formal Complaint. This contrasts with the approach followed by other regulators (notably the FSA) where a decision of this nature would be taken by an independent decision maker who was not responsible for the initial investigation. In our view it would be more appropriate for the CMC – or an alternative group designated by the Conduct Committee with no prior involvement in the case – to determine whether a Formal Complaint should be delivered, based on the case presented by the Executive Counsel.

4. Are the proposals to facilitate the timely completion of investigations and disciplinary proceedings appropriate (paragraphs 3.16 to 3.18)?

We agree that it is sensible to introduce a time limit for representations made by a Member or Member Firm, and also agree that eight weeks would be reasonable in most cases. In cases of particular size and complexity, our experience is that eight weeks may not be sufficient and the Member or Member Firm would need to invite the Executive Counsel to exercise his discretion to grant more time. We note that the Executive Counsel's discretion is "absolute" in this regard. Given that a refusal to extend the time could have a significant impact on a Member or Member Firm's ability to make comprehensive representations in respect of what could be very serious matters, we consider that there should be a clear means to challenge a refusal on the part of the Executive Counsel where it appears to the Member or Member Firm that his discretion has not been exercised reasonably, or that the Executive Counsel's power should be controlled by some other means to prevent it being exercised in a capricious, unreasonable or otherwise disproportionate manner.

5. Should the Executive Counsel be able to seek an interim order against a member or member firm? If so, are the proposed provisions (paragraph 3.19) appropriate?

We accept that interim orders may be appropriate in the most exceptional circumstances and note that the FRC's intention is that they will be reserved for such situations. The proposals in relation to interim orders in paragraph 13 and Appendix 2 of the Scheme (as amended) appear, on their face, to be sensible. However, given the draconian nature of the imposition of an interim order and the potentially far-reaching consequences for the Member or Member Firm involved (which may not be easily remediable if the Member or Member Firm is later absolved of any wrongdoing) we would expect to see clear and express procedural safeguards along the lines of those developed by the Courts in relation to interim injunctions in civil proceedings (i.e. the *American Cyanamid* principles).

Further, while the Member or Member Firm will be served with notice of the application for an interim order, the extent to which a Member of Member Firm will be able to make submissions in respect of that application is unclear. The process for dealing with an application for an interim order is simply stated to be "in accordance with the Regulations". The Regulations do provide for the Member or Member Firm to make representations in the context of disciplinary proceedings and appeals, but it is not clear how this will apply to applications for interim orders (which are not envisaged in the current version of the Regulations). Assuming that it is envisaged that the Member or Member Firm will be entitled to make representations, this should be made clear in the provisions of the Scheme.

Clearly, if there is to be scope for an interim order to be granted (or reviewed) in the absence of representations from a Member or Member Firm, this should be limited to situations of the utmost urgency, and any interim order granted in those circumstances should remain in effect for a minimal amount of time prior to representations being made in relation to the continuation of the order.

Finally, we note that paragraph 13(5)(iii) of the Scheme envisages guidance being issued by the Conduct Committee in relation to interim orders, but no firm commitment is made in this regard. We consider that if the Schemes remain in the form currently proposed, guidance should be issued (and potentially consulted upon) to provide Members and Member Firms

with some comfort as to how the interim order regime will operate and be applied in practice.

6. Do you have any comments on the proposals to amend the investigation test (paragraphs 3.24 to 3.29)?

We would welcome the amendment of the "misconduct criterion" in the manner described in the Consultation Paper. However, the stated reason for the amendment is that the existing criterion is "wide" in nature, and that as a result "*potential misconduct of any nature and significance might be regarded as sufficient to support the commencement of an investigation.*" This seems to identify two objectives for any amendment to the criterion: (i) that there should be reasonable grounds to suspect misconduct, as opposed to it only being necessary to show that an act of misconduct may "potentially" have taken place, and (ii) that the misconduct that is reasonably suspected should be more serious than an act of misconduct "of any nature and significance".

Assuming that this is so, while the proposed amendment to the "misconduct criterion" addresses the first of those objectives, it is not clear that it addresses the second. It may be that the wording at the end of paragraph 3.25 of the Consultation Paper ("*...which, if established through the investigation, would be sufficient to justify the commencement of disciplinary proceedings*") is intended to address the second point, but since the actual amendment is not yet reflected in the Scheme, it is difficult to comment in a more constructive manner. However, the position could be remedied by an amendment to the definition of "Misconduct", which could clarify the extent to which conduct must fall short of the standards reasonably to be expected of a Member or Member Firm before the conduct will qualify as "Misconduct" for the purposes of the Scheme.

7. Do you have any other comments on the proposed Schemes or the points raised in this paper?

We make the following further comments:

Paragraph 7(8)(ii)

The amendment of this paragraph removes the cost incentive for a Member Firm to make admissions in the context of disciplinary proceedings. While we note that the FRC considers that the impact of this amendment may be mitigated by the introduction of the new settlement procedures, we believe that the impact could be further mitigated by a provision whereby the conduct of both parties in the (unsuccessful) settlement discussions is taken into account in determining an appropriate award of costs.

Paragraph 14(4)

We are concerned that, as a result of the proposed amendments, a finding of fact in a report published by the FRC should be treated a prima facie evidence of that fact in proceedings conducted under the Scheme. Such a finding of fact may not have been tested by reference to all relevant evidence in the same way as if the Member Firm concerned had had the opportunity to make representations and file evidence in response to the relevant allegation(s). We do not see why the FRC should not have to prove a particular fact to the satisfaction of a tribunal in the light of that evidence and those representations.

Yours faithfully

Freshfields Bruckhaus Deringer LLP

Freshfields Bruckhaus Deringer LLP