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DOC ID LON21494526/1+
OUR REF CP/LK
YOUR REF
CLIENT MATTER NO. PMF-505959

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By email and post

13 July 2012

Dear Sirs

Response to the Accountancy and Actuarial Discipline Board's Consultation Paper: Sanctions Guidance to Tribunals (April 2012)

We regularly act for Accountancy firms and also consult on issues relating to regulation and sanctions with the Solicitors Regulatory Authority (the ***SRA***).

We have reviewed the Accountancy and Actuarial Discipline Board's Consultation Paper, 'Sanctions Guidance to Tribunals' (the ***Consultation Paper***) and the draft Indicative Sanctions Guidance (the ***Draft Guidance***) and set out below our responses to the questions posed in the Consultation Paper.

By way of preliminary comment we would, however, make three points.

First, there is a major difference between accountants, actuaries and solicitors who provide professional services and other regulated businesses. The quality of the advice given by a professional services firm is at the heart of its business and is driven by standards, training and culture. All businesses also need to protect against misconduct and regulators have a critical role to play in supporting and challenging businesses in this regard. But a professional services firm is much less exposed to misconduct of a nature that would lead to market abuse, cartel or other anti-competitive practices in relation to which other regulators impose very harsh sanctions.

Secondly, it is, therefore, necessary to define carefully the misconduct by a professional services firm which it is sought to deter and to ensure that any penalties do act as a deterrent of the misconduct concerned. We note that the AADB is also consulting on the test to be applied in launching investigations and that the five levels proposed seek to differentiate between different types of misconduct. They do not, however, recognise the basic proposition that in most instances "misconduct" will not be the main issue. In most cases there will either be issues relating to the nature of the advice given (which may also give rise to civil liability) or there will have been other primary drivers that have led to the situation at hand (with the accountants or lawyers playing a role ancillary to the actions of many others).

This leads us to the third point which is that any sanction to be imposed should have a direct bearing on the misconduct identified. A sanction should not punish. Nor should a Tribunal impose a sanction which is disproportionate. As well as addressing the sanctions to be imposed in a case of serious misconduct any regime should start by considering the overwhelming majority of cases that will come before a Tribunal. If the sanction of a fine calculated by reference to revenues is inappropriate for the majority of cases it should not be the starting point for all fines.

1. DO YOU AGREE WITH THE BOARD'S OBJECTIVES AND APPROACH TO SANCTIONS GUIDANCE?

1.1 We note that the Board has recognised, at paragraph 3.6 of the Consultation Paper, that the primary purpose of sanctions in a disciplinary context is "not to punish but to protect the public interest". We entirely agree with this objective which is why, for the reasons set out in detail below, we consider that the Board's proposed approach, of calculating fines which are based on a percentage of annual turnover, is inconsistent with its stated primary objective. We also note that the Board has not considered any alternatives to a broad percentage of annual turnover (such as a percentage of the audit fees for the client concerned or of the business unit) which is an approach adopted by other regulators.

2. DO YOU AGREE THAT TRIBUNALS NEED A CLEAR FRAMEWORK FOR SANCTIONS WHICH REFLECTS THE NATURE OF ITS CASES AND THE WIDER CONTEXT IN WHICH THE ACCOUNTANCY PROFESSION OPERATES TODAY?

2.1 We agree that Tribunals should be provided with guidance for sanctions which are appropriate to the context in which the accountancy profession operates today. However, in our view, the Board's proposed formulaic approach to calculating fines based on a percentage annual turnover, seems to us to be inconsistent with:

(i) the Board's recognition, at paragraph 3.12 of the Consultation Paper, that a principles based approach is preferable to a tariff based approach, in that the former provides the flexibility which the Board is seeking; and

(ii) the acknowledgment, at paragraph 3.11 of the Consultation Paper, that each case is different and that there is little uniformity in the types of issues and sorts of conduct involved.

2.2 The proposed 'one size fits all' approach of imposing a fine based on percentage annual turnover fails to consider the individual, and often divergent nature of the cases which will be before the Tribunals.

2.3 Moreover, the Consultation Paper relies upon the powers of other regulators to impose harsh fines in support of its own proposals, including the Office of Fair Trading (the ***OFT***) and the Financial Services Authority (the ***FSA***) which use a percentage turnover basis for calculating fines. In our view, it is not appropriate to draw comparisons with the fining regimes of these regulators as the types of case which they deal with, such as illegal price fixing agreements and intentional or profit driven misconduct, are very different to the types of breaches/misconduct that the AADB would have to pursue. We also note that whilst the FSA may, in certain cases, use a percentage of the "relevant" business revenue in order to calculate a penalty, such a basis is not automatically applied, rather, it may be considered appropriate to do so depending on the factors of a particular case.

2.4 In this regard we note that that the equivalent regulators in the USA, Australia, Canada and South Africa do not apply a percentage of turnover as the basis for calculating fines. That is no coincidence – it reflects a recognition that such an approach does not

address the underlying misconduct which the regulatory regime, as a whole, is designed to address.

2.5 Similarly, in the UK, the Solicitors Disciplinary Tribunal does not apply a percentage turnover basis for calculating fines. Indeed, the SRA has recently rejected the use of a percentage of revenue based approach to regulatory fines in respect of Alternative Business Structures due to concerns about certainty and costs. Whilst both professions would benefit from guidance on sanctions we see no reason, in principle, why accountants or actuaries should be exposed to such draconian sanctions when their business has, at its heart, a similar professional service.

3. DO YOU AGREE THAT THE SANCTIONS IMPOSED BY TRIBUNALS SHOULD ACT AS A CREDIBLE DETERRENT AND BE PROPORTIONATE TO THE SERIOUSNESS OF THE MISCONDUCT AND TO ALL THE CIRCUMSTANCES OF THE CASE, INCLUDING THE FINANCIAL RESOURCES OF MEMBERS AND THE SIZE AND FINANCIAL RESOURCES OF MEMBER FIRMS?

3.1 We agree, that in addition to the primary objective of protecting the public interest, the sanctions regime should act as a credible deterrent and that they should be proportionate to the seriousness of the misconduct.

3.2 However, we do not agree that a deterrent effect will only be achieved if monetary sanctions are imposed which have a significant financial impact on the Member Firm or Member, as suggested at paragraph 3.19 of the Consultation Paper.

3.3 No research has been cited in support of the view that higher penalties will automatically have an increased deterrent effect upon the profession. In particular, reputable firms take very seriously their obligations of compliance and such firms go to great lengths to ensure that their activities are carried out in a compliant manner. Rarely will issues occur because a Member Firm took a conscious decision not to be concerned about the quality of its advice or its regulatory obligations.

3.4 We note that in other analogous jurisdictions, where fines are not calculated on a percentage turnover basis, regulators do however have available other sanctions such as education, supervision for Members, third party reviews and prohibitions on accepting new clients for Member Firms. In our view, the AADB should consider employing a wider range

of sanctions which Tribunals are able to impose, beyond financial sanctions which are unlikely to achieve the desired deterrent effect in the majority of cases. Such an approach would be consistent with the AADB's stated primary objection of protecting the public and not punishing the profession.

3.5 We agree with the Board that the levels of fines imposed should reflect the seriousness of the offence (which itself should be gauged by reference to the majority of cases that come before a Tribunal). It follows, therefore, that the most severe sanctions should be reserved for the most serious acts of misconduct such as dishonesty or a breach of integrity. In our view if percentage of annual group turnover fines for all levels of misconduct are implemented the Draft Guidance will result in disproportionate sanctions being imposed. There should be a clear link between penalty levels and culpability- a general increase in fines seems likely to have the opposite effect. We consider this further in our response to question 6 below.

4. HAVE WE INCLUDED THE SORTS OF FACTORS IN THE SANCTIONS GUIDANCE THAT YOU WOULD EXPECT TO SEE TAKEN INTO ACCOUNT BY TRIBUNALS?

4.1 Yes.

5. ARE THERE ANY OTHER FACTORS YOU BELIEVE TRIBUNALS SHOULD TAKE INTO ACCOUNT WHEN DECIDING SANCTION THAT WE HAVE OVERLOOKED?

5.1 We would suggest one additional factor, namely, the overall quality of the advice provided by the firm or individual concerned in the particular case. That seems to us a legitimate public policy factor in assessing the impact of the particular instance at hand.

6. DO YOU AGREE THAT THERE NEEDS TO BE AN ADJUSTMENT IN THE LEVEL OF FINES IMPOSED IN AADB CASES?

6.1 We agree with the Board that the use of historic fines is not an appropriate benchmark for determining the level of sanctions going forward. However, we consider that in order to impose fines which are consistent, transparent, proportionate and fair, Tribunals must be given clear guidance on sanctions which distinguishes between the different types and degrees of misconduct. We do not consider that it is appropriate to use the same starting

point for the calculation of all fines, irrespective of the level of seriousness of the misconduct.

6.2 In this regard we recognise the benefit of guidance to Tribunals which distinguishes between various levels of misconduct as set out at paragraph 4.17 of the Consultation Paper but consider that more work needs to be done to differentiate between the primary and ancillary nature of any misconduct as explained in the second introductory point to this letter. In our view it would be appropriate for the Board to consider fixing maximum fines for some or all of the different levels of misconduct identified. This would be an appropriate starting point for the Tribunal in reaching its decision which should then be considered and adjusted in light of the relevant factors of a particular case. This approach has the benefit of transparency, certainty and proportionality.

6.3 We note that the FSA applies a similar approach in that a percentage of the relevant business revenue may be used as a basis for calculating fines. That percentage may be between 0%-20% (in five steps of 5%), depending on the nature and seriousness of the breach.

7. IF SO, WHAT ADJUSTMENTS DO YOU CONSIDER TO BE APPROPRIATE?

7.1 Please see our response to questions 3 and 6 above.

8. WHAT IS YOUR VIEW OF THE ALTERNATIVE MECHANISMS PROPOSED FOR CALCULATING FINES?

8.1 Please see our answers to questions 3 and 6 above. We note that all three alternative mechanisms employ the use of percentage of turnover as the basis for calculating fines. For the reasons stated above we consider such an approach to be inappropriate. Moreover, it appears that the Board has failed to consider a number of technical issues in the implementation of such a fining regime, including:

(i) the difficulty in ascertaining turnover - it is a malleable figure and there are various approaches to its calculation;

(ii) it is costly and time consuming to calculate turnover; and

(iii) there is an increased likelihood of appeal/legal challenge against the underlying basis for calculation of turnover, thereby increasing cost and delay for all parties.

8.2 In addition, it appears to us that the Board has overlooked a number of unintended consequences on the profession as a whole of a fining regime based on a percentage turnover basis such as:

(i) imposing disproportionately high fines may push some firms into insolvency which damages the interests of employees, creditors and stakeholders, whose conduct is entirely blameless, and may also adversely affect competition in the relevant market; and

(ii) the potential for disproportionately high levels of fines on individuals may discourage talented people from working in the relevant market in the UK.

9. WHAT LEVEL OF TURNOVER/INCOME DO YOU CONSIDER WOULD BE APPROPRIATE IN RESPECT OF EACH MECHANISM?

9.1 See our answers to question 6 above.

10. DO YOU AGREE THAT TRIBUNALS SHOULD NOT TAKE ACCOUNT OF THE COSTS THAT IT IS CONSIDERING AWARDING AGAINST A MEMBER OR MEMBER FIRM WHEN DETERMINING THE APPROPRIATE LEVEL FOR A FINE?

10.1 Yes.

Yours faithfully

Freshfields Bruckhaus Deringer LLP

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